

Spring 2000

## Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers

Kathryn L. Moore

Follow this and additional works at: <https://scholarship.law.missouri.edu/mlr>



Part of the [Law Commons](#)

---

### Recommended Citation

Kathryn L. Moore, *Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers*, 65 MO. L. REV. (2000)

Available at: <https://scholarship.law.missouri.edu/mlr/vol65/iss2/1>

This Article is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Missouri Law Review by an authorized editor of University of Missouri School of Law Scholarship Repository. For more information, please contact [bassettcw@missouri.edu](mailto:bassettcw@missouri.edu).

# MISSOURI LAW REVIEW

---

VOLUME 65

SPRING 2000

NUMBER 2

---

## **Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers**

*Kathryn L. Moore\**

### TABLE OF CONTENTS

I.	INTRODUCTION .....	342
II.	HOW PARTIAL PRIVATIZATION DIFFERS FROM THE CURRENT SYSTEM .....	346
	<i>A. Investment Risk</i> .....	347
	<i>B. Pre-funding of Benefits</i> .....	348
III.	EFFECT OF PARTIAL PRIVATIZATION ON AT-RISK BENEFICIARIES .....	352
	<i>A. Investment Risk</i> .....	353
	1. Investment Experience .....	354
	2. Risk Aversion .....	357
	3. Investment Education .....	360
	4. Conclusion .....	366
	<i>B. Payout of Benefits</i> .....	366
	1. Mandatory Annuitization .....	368
	2. Voluntary Annuitization of Lump Sum Accumulations ...	377
	3. Risk of Market Downturn .....	381
	4. Conclusion .....	383
	<i>C. Progressive Benefit Formula</i> .....	384
	<i>D. Disability Benefits</i> .....	388
	<i>E. Auxiliary Benefits</i> .....	392
	1. Spouse and Surviving Spouse Benefits .....	392
	2. Dependent Child Benefits .....	401
	3. Conclusion .....	401
IV.	CONCLUSION .....	402

## I. INTRODUCTION

Once viewed as the “third rail” of politics,<sup>1</sup> Social Security<sup>2</sup> appears to be moving inexorably toward reform.<sup>3</sup> In his 1998 State of the Union address, President Clinton proclaimed strengthening Social Security a high priority<sup>4</sup> and called for bipartisan forums on Social Security reform to be held throughout the United States.<sup>5</sup> Similarly, following the 1998 November elections, congressional leaders expressed commitment to “saving Social Security,”<sup>6</sup> and House Ways

\* Associate Professor of Law, University of Kentucky, College of Law. A.B. 1983, University of Michigan; J.D. 1988, Cornell Law School.

The Author is grateful to Richard C. Ausness, Karen C. Burke, Michael P. Healy, Brian A. Jones, Robert J. Myers, and John M. Rogers for their comments on earlier drafts and to Lisa Graening, Carol Paris, Amy Shoemaker, and Jeffrey Wilder for their research assistance.

1. See *Gregg Says He Opposes Creation of Panel to Address Social Security*, 25 PENS. & BEN. REP. (BNA) 805, 806 (1998) (“Social Security has often been referred to as ‘the third rail’ of politics, but the political climate has changed.”); *Social Security—Retirees Can’t Live Without It, It Can’t Survive Without Reform*, 13 BEN. Q. 8, 8 (1997) (stating that “Social Security has come to be known as the ‘third rail’ of politics” because it is the dominant source of income for the retired population).

2. For purposes of this Article, the term Social Security will be used in its generally accepted manner as referring only to the cash benefits provided by the Old-Age, Survivors, and Disability Insurance (“OASDI”) program. The Old-Age and Survivors Insurance (“OASI”) program provides benefits for retired workers and their spouses and children and to survivors of deceased workers. The Disability Insurance (“DI”) program provides benefits for disabled workers and their spouses and children and pays for rehabilitation services for the disabled. See Martynas A. Ycas, *The Issue Unresolved: Innovating and Adapting Disability Programs for the Third Era of Social Security*, 58 SOC. SEC. BULL. 48, 49 (1995).

3. See Sylvester J. Schieber, *A Framework and Proposal for Social Security Reform*, 22 WASH. Q. 157, 157 (1999) (declaring that “Social Security reform is a certainty”).

For a discussion of the reasons underlying the need for reform, see Kathryn L. Moore, *Redistribution Under the Current Social Security System*, 61 U. PITT. L. REV. (forthcoming 2000) and authorities cited therein.

4. President William Clinton, *Address Before a Joint Session of the Congress on the State of the Union*, WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Feb. 2, 1998, at 129; *Global Executives Give High Rankings to Social Security Private Account Approach*, 25 PENS. & BEN. REP. (BNA) 806, 806 (1998).

5. *First of Social Security Forums Scheduled for April 7 in Kansas City, Mo.*, 25 PENS. & BEN. REP. (BNA) 803, 803 (1998).

6. See, e.g., *1999 Could Be Year of Action on Retirement Security Issues*, *Sources Say*, 26 PENS. & BEN. REP. (BNA) 69, 70 (1999).

In a Jan. 6 speech to House members, House Speaker Dennis Hastert (R-Ill.), said retirement and health security are among the top challenges the country

and Means Chairman Bill Archer renewed his commitment to bipartisan reform of Social Security as recently as December 8, 1999 in a letter to President Clinton.<sup>7</sup> Congressional hearings on reform proposals are ubiquitous,<sup>8</sup> and discussions regarding Social Security and its possible reform flood the popular press.<sup>9</sup>

While reform proposals vary,<sup>10</sup> proposals to privatize the system partially; that is, to provide some, but not all, benefits through pre-funded individual accounts, are among the most popular of the reform proposals.<sup>11</sup> Often differing

faces in 1999. 'We must make sure that Social Security is there for those who depend upon it and those who expect to. We must consider options for younger workers so they can look forward to an even brighter retirement,' said Hastert.

*Id.*; see also *GOP Leaders Pledge to 'Save' System; Republican Members Invited to Conference*, 25 PENS. & BEN. REP. (BNA) 2836, 2836 (1998) ("Senate Majority Leader Trent Lott (R-Miss.) and House Speaker-elect Bob Livingston (R-La.) Dec. 3 said 'saving Social Security' is part of their common agenda for the 106th Congress."); *Social Security, tax cuts top GOP leaders' '99 agenda*, LEXINGTON HERALD-LEADER, Dec. 4, 1998, at A9 ("Congress will focus next year on buttressing Social Security, cutting taxes and improving schools, the two Republicans who will lead the House and Senate said yesterday.").

7. See *Rep. Archer Urges Administration To Take Action on Shoring up System*, 26 PENS. & BEN. REP. (BNA) 2885, 2885 (1999).

8. For example, the House Ways and Means Committee scheduled a hearing focusing on Social Security reform proposals for January 21, 1999, while the Senate Budget Committee planned a series of hearings on "Social Security in the 21st Century" in 1999. See *Archer Announces Jan. 21 Hearing; Kennelly, Kemp, Jackson to Speak*, 26 PENS. & BEN. REP. (BNA) 147 (1999). The House Ways and Means Committee again scheduled hearings on Social Security for June 9-10, 1999; *Archer Schedules June 9-10 Hearings; Apfel Says Reform Difficult But Not Dead*, 26 PENS. & BEN. REP. (BNA) 1459, 1459 (1999).

9. See, e.g., *An American Discusses Social Security: One of a Series of Views*, NEWSWEEK, Apr. 27, 1999, at 66-67; Ellen Goodman, *Seniors Will Have To Keep Working—If Anyone Will Let Them*, LEXINGTON HERALD-LEADER, May 26, 1998, at A11; Ron Hutcheson, *Plans To Link Social Security, Markets Gaining Popularity*, LEXINGTON HERALD-LEADER, Apr. 23, 1998, at A13; Jane Bryant Quinn, *Reforms Will Change retirement planning*, LEXINGTON HERALD-LEADER, May 31, 1998, at E1; David Segal, *At the Cato Institute, An Idea Catches On; Think Tank Is Thrust Into Social Security Debate*, WASH. POST, Jan. 30, 1999, at E1; *Should Social Security Be Privatized?: Two Congressmen Debate the Issue*, LEXINGTON HERALD-LEADER, June 1, 1998, at A9; Michael M. Weinstein, *A Wrong Turn on the Road to Social Security Reform*, N.Y. TIMES, May 6, 1999, at C2.

10. For a comparison of the details of a wide range of reform proposals, see Kelly Olsen, *Appendix: A Point-by-Point Comparison of Social Security Reform Plans*, 13 BEN. Q. 88 (1997).

11. See *Smith Bill Would Start Pilot Program of Personal Accounts for Young Workers*, PENS. & BEN. DAILY (BNA), Apr. 11, 1998, at d5. The article stated:

As discussion of Social Security reform gains a higher profile in the wake of

in detail,<sup>12</sup> the partial privatization proposals typically share a number of common elements. First, like the current system,<sup>13</sup> most partial privatization proposals require that workers contribute some portion of their earnings to finance their Social Security benefits. Most partial privatization proposals then require that some portion of these contributions be used to fund individual accounts, and that workers invest those individual accounts in one or more private funds. Finally, most proposals provide workers with two tiers of benefits. The first tier benefit may consist of a flat benefit that all workers receive regardless of their earnings or, like the current system, the first tier benefit may be based in part on earnings, but provide a greater return on lower wages than on higher wages. The second tier benefit consists of the contributions to the individual account and any earnings or losses thereon.

This Article explains why partial privatization would likely have a disproportionately adverse effect on the benefits of three specific subpopulations: women, minorities, and lower-income workers. The Article focuses on these three groups principally because they are at a heightened risk of poverty in old age.<sup>14</sup> Since one of the fundamental purposes of Social Security is to provide for progressive redistribution to lift the elderly out of poverty,<sup>15</sup> policymakers should be (and are)<sup>16</sup> concerned with how Social Security reform would likely affect

---

President Clinton's 'save Social Security first' message in his State of the Union address, the notion of creating individual, privately invested retirement accounts is consuming a substantial amount of the debate. In a January speech, House Speaker Newt Gingrich (R-Ga) urged personal retirement accounts. Sen. Daniel Patrick Moynihan (D-NY), the ranking Finance Committee democrat, introduced a Social Security reform bill (S. 1792) to provide for voluntary personal retirement accounts. In addition, Senate Finance Committee Chairman William V. Roth (R-Del) and House Budget Committee Chairman John Kasich (R-Ohio) have called for future budget surpluses to be divided among 'Social Security plus accounts' for American workers.

*Id.* (citations omitted); see also *Public Is Interested in Private Accounts, But Concerned About Logistics, Phillips Says*, 25 PENS. & BEN. REP. (BNA) 1161, 1161 (1998) (noting that private accounts were discussed more than any other topic at the Kansas City forum on Social Security); *Retirees Can't Live Without It*, *supra* note 1, at 13.

12. See, e.g., Kathryn L. Moore, *Privatization of Social Security: Misguided Reform*, 71 TEMP. L. REV. 131, 151-53 (1998) (describing differences between Advisory Council's IA and PSA plans).

13. This Article assumes that the reader has a basic understanding of how the current system operates. For those who would like more details, see Moore, *supra* note 3, app., and authorities cited therein for an overview of the funding and benefit structure of the current system.

14. See Moore, *supra* note 3, § II.

15. See Kathryn L. Moore, *Redistribution Under a Partially Privatized Social Security System*, 64 BROOK. L. REV. 969, 970 n.5, 988 & n.80 (1998).

16. For expressions of such interest, see Moore, *supra* note 3, introduction.

these subpopulations.<sup>17</sup> Of course, not all women and minorities are at heightened risk of poverty in old age.<sup>18</sup> To the extent that members of these groups are not at a heightened risk of poverty in old age, public policy may not dictate that Social Security reform accord them any special protection. Nevertheless, policymakers should still be aware of any disparate impact Social Security reform may have on these groups.<sup>19</sup> Accordingly, this Article analyzes

---

17. Social Security's redistributive goal is not without its critics. *See, e.g., supra* note 15, at 970 n.8. Yet even critics of the current system point to the effect on the at-risk populations in promoting their reform proposals. *See, e.g.,* WILLIAM W. BEACH & GARETH G. DAVIS, SOCIAL SECURITY'S RATE OF RETURN (Heritage Ctr. for Data Analysis Rep. No. 98-01, 1998) [hereinafter RATE OF RETURN]; WILLIAM W. BEACH & GARETH G. DAVIS, SOCIAL SECURITY'S RATE OF RETURN FOR HISPANIC AMERICANS (Heritage Ctr. for Data Analysis Rep. No. 98-02, 1998); CARRIE LIPS, THE WORKING POOR AND SOCIAL SECURITY PRIVATIZATION (CATO Inst. Briefing Paper No. 40, 1998); DARCY ANN OLSEN, GREATER FINANCIAL SECURITY FOR WOMEN WITH PERSONAL RETIREMENT ACCOUNTS (CATO Inst. Briefing Paper No. 38, 1998); EKATERINA SHIRLEY & PETER SPIEGLER, THE BENEFITS OF SOCIAL SECURITY PRIVATIZATION FOR WOMEN (CATO Project on Soc. Sec. Privatization No. 12, 1998); MICHAEL TANNER, PRIVATIZING SOCIAL SECURITY: A BIG BOOST FOR THE POOR (CATO Project on Soc. Sec. Privatization No. 4, 1996). For critiques of the Heritage reports, see Dorothy A. Brown et al., *Social Security Reform: Risks, Returns, and Race*, CORNELL J.L. & PUB. POL'Y (forthcoming); Kilolo Kijakazi, *African Americans, Hispanic Americans, and Social Security: The Shortcomings of the Heritage Foundation Reports, in* CENTER ON BUDGET AND POLICY PRIORITIES (1998), available in <<http://www.cbpp.org/10-5-98socsec.html>>.

18. In fact, Asian/Pacific Islanders have the highest median income of any racial/ethnic group in the United States. *See* U.S. BUREAU OF THE CENSUS, MONEY INCOME FOR THE UNITED STATES: 1997 CURRENT POPULATION REPORTS, CONSUMER INCOME P60-200 vii tbl.A (showing that median income in 1997 was \$45,249 for Asian/Pacific Islanders, \$40,577 for whites not of Hispanic origin, \$26,628 for Hispanics, and \$25,050 for blacks).

19. *Cf.* Dorothy A. Brown et al., *supra* note 17 (stating that "no serious [Social Security] reform proposal can any longer ignore the issue of racial equity in the debate over social security"); Erik Jensen, *Critical Theory and the Loneliness of the Tax Prof*, 76 N.C. L. REV. 1753, 1756-57 (1998) ("If a critic can demonstrate that the Internal Revenue Code has had unfortunate effects on particular groups (call this 'mild' feminism or 'mild' critical race theory), we certainly ought to know that."); Marjorie E. Kornhauser, *Through the Looking Glass With Alice and Larry: The Nature of Scholarship*, 76 N.C. L. REV. 1609, 1615-16 n.27 (1998) ("Even if the tax system were neutral on balance, there is still merit in examining individual provisions to see their effects on different segments of the population."); William C. Whitford, *Remarkable*, 76 N.C. L. REV. 1639, 1644 (1998) (contending that "race concerns should always be considered in the policy mix" even if they do not always trump other policy concerns). *But see* Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 N.C. L. REV. 1520, 1524 (1998) (questioning value of merely examining provisions of Tax Code for racial effect: "It is unfair to criticize current law for its effects on women or blacks without showing a way to do better; more important, mere critique without a workable solution does nothing to better anyone's situation").

how partial privatization would likely affect the benefits of all three subpopulations, regardless of whether they face a heightened risk of poverty in old age. For ease of reference, this Article will refer to the three subpopulations as "at-risk" or "more vulnerable" even though individual members of the groups may not face a higher risk of poverty.

The Article begins by explaining how partial privatization differs fundamentally from the current system. The Article then explains why partial privatization would likely have an adverse effect on the benefits of women, minorities, and lower-income workers. Specifically, it explains why shifting investment risk to workers, the fundamental indispensable difference between the current system and a partially privatized system, would likely have an adverse impact on the benefits of the three at-risk groups. It then explains how distribution of benefits to the three subpopulations would be impacted by partial privatization's interaction with the four factors—(1) payout of benefits, (2) progressive benefit formula, (3) disability benefits, and (4) auxiliary benefits<sup>20</sup>—most relevant in determining how the current system redistributes income. The Article does not analyze any single partial privatization proposal, although it does refer to specific proposals when relevant.

## II. HOW PARTIAL PRIVATIZATION DIFFERS FROM THE CURRENT SYSTEM

Recently, a number of groups and individuals have proposed partial privatization of Social Security as a solution, or partial solution, to the program's long-term funding problems. For example, seven of the thirteen members of the 1994-1996 Social Security Advisory Council<sup>21</sup> ("Advisory Council") have proposed that Social Security be partially privatized.<sup>22</sup> Similarly, the Committee for Economic Development<sup>23</sup> and the National Commission on Retirement

---

20. See Moore, *supra* note 3 (discussing how these four factors affect redistribution within the current Social Security system).

21. In recent years, an Advisory Council on Social Security was appointed every four years by the Secretary of Health and Human Services to review the status of all of the Social Security trust funds in relation to the long-term commitments of the Social Security programs. See I U.S. ADVISORY COUNCIL ON SOCIAL SECURITY, REPORT OF THE 1994-1996 ADVISORY COUNCIL ON SOCIAL SECURITY 2 (1997) [hereinafter ADVISORY COUNCIL REPORT]. For a description of the Advisory Council partial privatization proposals, see *id.* at 28-33.

22. *Id.*

23. See FIXING SOCIAL SECURITY: A STATEMENT BY THE RESEARCH AND POLICY COMMITTEE OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT (1997), available in <http://www.ced.org>.

The Committee for Economic Development [CED] is an independent research and policy organization of some 250 business leaders and educators. CED is nonprofit, nonpartisan, and nonpolitical. Its purpose is to propose policies

Policy<sup>24</sup> have offered partial privatization proposals. In addition, members of Congress have repeatedly introduced bills that would partially privatize Social Security.<sup>25</sup>

The partial privatization proposals differ from the current system in two fundamental ways. First, partial privatization shifts investment risk from the federal government to individual workers. Second, partial privatization involves the pre-funding of benefits. Only the first of these two differences, however, is a necessary prerequisite to partial privatization.<sup>26</sup>

### A. Investment Risk

There are two basic types of retirement plans: defined benefit plans and defined contribution plans. A defined benefit plan is one in which the benefit is expressed as a certain amount to be paid at the participant's retirement. Typically, such plans provide for a fixed amount per month to be paid for the life of the retired participant and spouse. The fixed amount is generally based on a

---

that bring about steady economic growth at high employment and reasonably stable prices, increased productivity and living standards, greater and more equal opportunity for every citizen, and an improved quality of life for all.

*Id.* For a description of the CED's partial privatization proposal, see *id.* at 2-3, 49-51.

24. The National Commission on Retirement Policy ("NCRP") is a bipartisan panel consisting of lawmakers, economists, and private sector experts. *Panel Proposes Personal Accounts, Raising Retirement Eligibility Age*, 25 PENS. & BEN. REP. (BNA) 1203, 1203 (1998). It is an initiative of the Center for Strategic and International Studies, a public policy research institution located in Washington, D.C. See NATIONAL COMMISSION ON RETIREMENT POLICY, CAN AMERICA AFFORD TO RETIRE? THE RETIREMENT SECURITY CHALLENGE FACING YOU (1998). For more information on the NCRP, see *The National Commission on Retirement Policy* (visited Feb. 25, 2000) <<http://www.csis.org/retire/>>. For a description of the NCRP partial privatization proposal, see NATIONAL COMMISSION ON RETIREMENT POLICY, THE 21ST CENTURY RETIREMENT SECURITY PLAN (1998) [hereinafter THE 21ST CENTURY RETIREMENT SECURITY PLAN].

25. See, e.g., S. 1383, 106th Cong. (1999); H.R. 1793, 106th Cong. (1999); S. 2369, 105th Cong. (1998); S. 1792, 105th Cong. (1998); H.R. 3560, 105th Cong. (1998); H.R. 3456, 105th Cong. (1998); S. 321, 105th Cong. (1997); H.R. 3082, 105th Cong. (1997); H.R. 2929, 105th Cong. (1997); H.R. 2782, 105th Cong. (1997); H.R. 2768, 105th Cong. (1997); H.R. 1611, 105th Cong. (1997).

26. Some analysts view proposals that involve the federal government investing in the private market and bearing the risk as privatization proposals. See, e.g., *Proposals for Alternative Investment of the Social Security Trust Fund Reserves: Hearing Before the Subcomm. on Social Security of the House Comm. on Ways and Means*, 103d Cong. 111 (1994) (treating proposals in which federal government invests in private market as privatization proposals); Bob Davis, *A Consensus Emerges*, WALL ST. J. EUR., July 10, 1996, at 1 (same). As discussed at the beginning of this Article, however, this Article only treats proposals that provide all or part of benefits through pre-funded individual accounts as privatization proposals.



formula that takes into account the participant's years of service and salary. Plan assets are pooled together to meet the demands of all of the participants, and the plan sponsor bears the investment risk.<sup>27</sup>

Defined contribution plans, unlike defined benefit plans, do not promise participants a certain benefit upon retirement. Instead, benefits under a defined contribution plan are based on contributions to the plan and any earnings or losses on those contributions. Typically, the employer contributes a fixed amount to each individual account established on behalf of each participant, and the account is credited with any earnings or losses on those contributions. Upon retirement, the participant is entitled to a benefit based upon the amount held in the account rather than a fixed benefit based on the participant's years of service and compensation. Thus, unlike a participant in a defined benefit plan, the participant in a defined contribution plan bears the investment risk.<sup>28</sup>

The current Social Security system promises participants a specific benefit based on a complex formula.<sup>29</sup> Because the current system promises a specific benefit, it is a defined benefit retirement program.<sup>30</sup> As such, the plan sponsor, or government, bears the investment risk. In contrast, the partial privatization proposals add a second-tier, defined contribution, element to the current system. The partial privatization proposals do not promise workers a specific benefit from their second tier; instead, the second tier benefit consists of workers' contributions to their individual accounts and any earnings or losses thereon. Accordingly, the partial privatization proposals differ fundamentally from the current system because they subject workers to investment risk.

### *B. Pre-funding of Benefits*

Unlike the current Social Security system, which is funded principally on a pay-as-you-go basis,<sup>31</sup> all of the partial privatization proposals currently under serious consideration require that the second tier benefit be funded in advance.<sup>32</sup>

27. See Moore, *supra* note 12, at 137 n.42.

28. See Moore, *supra* note 12, at 137 n.42.

29. See 42 U.S.C. § 415 (1994). For a more detailed discussion of how these benefits are calculated, see Moore, *supra* note 4, app.

30. Cf. A FRAMEWORK FOR ANALYZING AND COMPARING SOCIAL SECURITY POLICIES 6 (EBRI Issue Brief No. 183, 1997) [hereinafter ISSUE BRIEF NO. 183] ("In a defined benefit plan, such as the current Social Security system, the goal is to guarantee that, if workers participate, they receive benefits in an amount dictated by a predetermined formula.").

31. For a more detailed discussion of the way in which the current system is funded, see Moore, *supra* note 3, app.

32. Partial privatization does not require pre-funding of benefits. For example, Latvia recently established a privatized but unfunded pension system in which payroll taxes are collected by the government and credited to workers' "notional" accounts with paper returns on contributions. Similarly, the United States could create a privatized

In fact, the principal justification for the partial privatization proposals derives from the potential advantages of a pre-funded system.<sup>33</sup>

Because the current system is financed principally on a pay-as-you-go basis, the system is limited in the rates of return it can provide participants. If population and tax rates remain constant over time, a mature pay-as-you-go system, like the current Social Security system, can only provide retirees with an average return on contributions that is equal to the growth in real wages.<sup>34</sup> Since the growth in real wages is projected to be about one percent each year for the foreseeable future and the working population is projected to shrink relative to the beneficiary population, the current system faces the specter of providing future retirees with an average return of less than one percent.<sup>35</sup>

A pre-funded system, in contrast, offers the potential of higher rates of return.<sup>36</sup> Over the last one hundred years, average long-term rates of return on equities have been about seven percent per year.<sup>37</sup> If Social Security

---

Social Security system without pre-funding. See John Geanakoplos et al., *Would a Privatized Social Security System Really Pay a Higher Rate of Return?*, in *FRAMING THE SOCIAL SECURITY DEBATE* 137, 141 (R. Douglas Arnold et al. eds., 1998). In fact, however, all of the partial privatization proposals provide for pre-funding of the second tier individual account benefit.

33. Proponents may offer additional justifications for partial privatization. For example, Representative John Porter claimed that his proposal to partially privatize Social Security on a temporary basis would (1) unmask the federal government's general budget deficit, (2) increase the national savings rate and American competitiveness, and (3) provide "individuals an opportunity to improve their overall retirement income by earning a higher return on their contributions in the private sector than under Social Security." U.S. GENERAL ACCOUNTING OFFICE, *SOCIAL SECURITY: ANALYSIS OF A PROPOSAL TO PRIVATIZE TRUST FUND RESERVES 1* (1990) [hereinafter *PROPOSAL TO PRIVATIZE*]. For a discussion of the effect of a funded system on national savings and the unmasking of the federal deficit, see, e.g., Barry P. Bosworth, *Fund Accumulation: How Much? How Managed*, in *SOCIAL SECURITY: WHAT ROLE FOR THE FUTURE* 89 (Peter A. Diamond et al. eds., 1996); *Promoting National Saving Through Social Security Trust Funds*, in *SOCIAL SECURITY'S LOOMING SURPLUSES: PROSPECTS AND IMPLICATIONS* 17-38 (Carolyn L. Weaver ed., 1990). For additional discussion on the advantages of advance funding, see U.S. GENERAL ACCOUNTING OFFICE, *SOCIAL SECURITY: DIFFERENT APPROACHES FOR ADDRESSING PROGRAM SOLVENCY* GAO/HEHS-98-33, 29 (1998) [hereinafter *DIFFERENT APPROACHES*]. See also John B. Williamson, *A Critique of the Case for Privatizing Social Security*, 37 *GERONTOLOGIST* 561 (1997) (describing and responding to 10 arguments provided in support of privatization).

34. See Moore, *supra* note 15, at 975-76.

35. See Moore, *supra* note 15, at 975-76.

36. But see JOHN MUELLER, *WINNERS AND LOSERS FROM PRIVATIZING SOCIAL SECURITY: A REPORT COMMISSIONED BY THE NATIONAL COMMITTEE TO PRESERVE MEDICARE* 4 n.5 (1999) (noting that privatizers ignore the other half of "[Paul] Samuelson's conclusion: That the long-run rate of return on pay-as-you-go Social Security would be higher than the yield on financial assets of similarly low risks").

37. Narayana R. Kocherlakota, *The Equity Premium: It's Still a Puzzle*, 34 *J.*

contributions were invested in the private equities market, the system would have the potential of reaping these higher rates of return.<sup>38</sup> Proponents of partial privatization contend that partial privatization would benefit all workers, no matter their income level, by permitting them to invest in the equities market and thus reap these higher returns.<sup>39</sup>

---

ECON. LITERATURE 42, 42 (1996). The average annual real return on stocks from 1926 to 1996 was 9.4%. See Geanakoplos et al., *supra* note 32, at 142.

38. Some analysts object to comparing the current system's rates of return with those of equities. See, e.g., DEAN BAKER, PRIVATIZING SOCIAL SECURITY: THE WALL STREET FIX (Economic Policy Institute Brief No. 112, 1996) (contending that "relevant measure is not the rate of return provided by Social Security benefits relative to the taxes paid in, but rather the improvements in living standards over generations"); Geanakoplos et al., *supra* note 32, at 12-23 (contending that such comparisons are not appropriate because they fail to take into account transition costs and differences in investment risk). Other analysts note that there is some risk that investing Social Security funds in the private market could lower the return on equities. See, e.g., ISSUE BRIEF NO. 183, *supra* note 30, at 15 (stating that "given a reallocation of the Social Security assets, the assumption that equity returns would remain at their current levels is not one to be taken without careful thought about market interactions"). Others note that the retirement of the baby boom generation could depress the rate of return on equities. See SYLVESTER J. SCHIEBER & JOHN B. SHOVEN, THE AGING OF THE BABYBOOM GENERATION 18-20 (1996) (noting that the retirement of baby boomers could cause the rate of return on equities to fall by roughly 5% per year between 2010 and 2030 but contending that presence of global capital market, rational expectations, and the fact that corporate assets are cash-generating depreciable property is likely to alleviate at least some of that decrease).

39. See, e.g., I ADVISORY COUNCIL REPORT, *supra* note 21, at 36-49 (comparing rates of return under the three Advisory Council proposals); FIXING SOCIAL SECURITY, *supra* note 24, at 44 (recognizing that not everyone is likely to receive higher returns on their contributions but contending that investments in the private sector are likely to improve the "money's worth" of contributions made by the majority of younger workers); THE 21ST CENTURY RETIREMENT SECURITY PLAN, *supra* note 24, at 3 ("The Commission is persuaded that most Americans will receive more retirement income from the Social Security program if individual savings accounts are incorporated into the system than they would receive if traditional solutions alone were used to bring the system back into balance."); Sylvester J. Schieber, *The Need for Social Security Reform and the Implications of Funding Through Personal Security Accounts*, 13 BEN. Q. 29, 38 (1997). Schieber states:

According to the projections developed by the Social Security actuaries for the Advisory Council, the PSA proposal offers the potential for both low-wage and high-wage workers to become better off under a proposal of this sort than under the extremely low rates of return provided under the current system as a result of the funding of benefits that is an important element of the proposal.

*Id.*; see also Steve Forbes, *How to Replace Social Security*, WALL ST. J., Dec. 18, 1996, at A20 ("[T]he average worker retiring today receives a lifetime return of only about 2.2% on the taxes he has paid into the system. . . . Contrast this with the historic 9% to

The current system need not be partially privatized; that is, individual accounts need not be added to the system to provide for advance funding of the system.<sup>40</sup> Indeed, the Social Security system originally provided for the creation of a substantial reserve.<sup>41</sup> Moreover, the current system need not be partially privatized to provide for investment in the private securities market. The system is currently running a surplus and that surplus could be invested in the private securities market.<sup>42</sup> In fact, six members of the Advisory Council recommended that the possibility of investing a significant portion of the Social Security trust fund in the equities market be studied,<sup>43</sup> and President Clinton proposed in his 1999 State of the Union address that part of the current Social Security surplus be invested in private securities.<sup>44</sup>

---

10% annual returns from stock market investments. . . . The advantages of an IRA-type approach are overpowering.”); BEACH & DAVIS, *RATE OF RETURN*, *supra* note 17, at 6-9 (contending that Social Security rate of return for most Americans will be vastly inferior to what they could expect from placing their payroll taxes in even the most conservative private investments); LIPS, *supra* note 17, at 1 (contending that poor would benefit most from privatization).

40. See Geanakoplos et al., *supra* note 32, 139-41 (noting that “[i]t is also possible to raise system funding without involving individual accounts; taxes could be raised or benefits cut and the proceeds could be put into a central trust fund”).

41. See CHARLES M. BRAIN, *SOCIAL SECURITY AT THE CROSSROADS* 56 (1991); J. DOUGLAS BROWN, *AN AMERICAN PHILOSOPHY OF SOCIAL SECURITY: EVOLUTION AND ISSUES* 179 (1972).

42. Current law, however, would have to be amended to permit investment in the private equities market. See 42 U.S.C. § 401(d) (1994) (limiting investment of the trust fund to interest bearing obligations of the United States or obligations guaranteed as to both principal and interest by the United States).

For analyses of the wisdom of investing the Social Security trust fund in the private equities market, see, e.g., U.S. GENERAL ACCOUNTING OFFICE, *SOCIAL SECURITY FINANCING: IMPLICATIONS OF GOVERNMENT STOCK INVESTING FOR THE TRUST FUND, THE FEDERAL BUDGET, AND THE ECONOMY* GAO/AIMD/HEHS-98-74 (1998); Theodore J. Angelis, *Investing Public Money in Private Markets: What Are the Right Questions?*, in *FRAMING THE SOCIAL SECURITY DEBATE: VALUES, POLITICS, AND ECONOMICS* 287 (R. Douglas Arnold et al. eds., 1998); Gary Burtless, *Investment Policy for the Social Security Trust Funds*, in *SOCIAL SECURITY AND ECONOMIC WELL-BEING ACROSS GENERATIONS* 89, 96-98 (John R. Gist ed., 1988); MICHAEL LEIDY, *INVESTING U.S. SOCIAL SECURITY TRUST FUND ASSETS IN PRIVATE SECURITIES* (IMF Working Paper 97-112, 1997); Gene Steuerle, *Investing Social Security Surpluses in the Stock Market*, 66 *TAX NOTES TODAY* 1867 (1995); 67 *TAX NOTES TODAY* 129 (1995); 67 *TAX NOTES TODAY* 287 (1995) (a three part series).

43. I ADVISORY COUNCIL REPORT, *supra* note 21, at 25.

44. See *At the Cato Institute, An Idea Catches On: Think Tank Thrust Into Debate on Social Security*, WASH. POST, Jan. 30, 1999, at E1 (“In Clinton’s State of the Union address, he called on Congress to earmark a hefty chunk of projected budget surpluses for Social Security and channel at least \$650 billion of the money into stocks over the next 15 years.”). President Clinton later backed away from that proposal in 1999 but

### III. EFFECT OF PARTIAL PRIVATIZATION ON AT-RISK BENEFICIARIES

Determining how partial privatization of Social Security would likely affect the benefits of any particular worker or group of workers is not easy. The current system is extraordinarily complex and determining rates of return under the current system or any amendment to that system "involves many judgments and is not easily answered with general aggregate numbers."<sup>45</sup>

This Article does not attempt to develop a mathematical model to generate an aggregate number to determine how partial privatization would likely affect the benefits of the at-risk groups.<sup>46</sup> Instead, the Article analyzes five separate facets of a partially privatized system to explain why it would likely have an adverse impact on the benefits of the at-risk groups.

It first addresses partial privatization's shift of investment risk to workers, the fundamental indispensable difference between the current system and a partially privatized system. It then analyzes partial privatization's interaction with the four elements of the current system that are most relevant in determining how it redistributes income. Those elements are: (1) payout of benefits, (2) progressive benefit formula, (3) disability benefits, and (4) auxiliary benefits.<sup>47</sup>

---

reintroduced the idea in his 2001 budget. *Cf. Clinton Fiscal 2001 Budget Plan Includes Equity Investment of Social Security Assets*, 27 PENS. & BEN. REP. (BNA) 466, 466 (2000) ("The Clinton administration's fiscal 2001 budget proposal, transmitted to Congress Feb. 7, revisits the idea of investing Social Security Trust assets in equities, a proposal the administration dropped last year after it proved too controversial to garner bipartisan support.").

45. STAFF OF HOUSE COMM. ON WAYS AND MEANS, 105TH CONG., 1998 GREEN BOOK 86 (Comm. Print 1998).

46. For a discussion of a computer model that was developed for this purpose, see KELLY A. OLSEN ET AL., HOW DO INDIVIDUAL SOCIAL SECURITY ACCOUNTS STACK UP? AN EVALUATION USING THE EBRI-SSASIM2 POLICY SIMULATION ANALYSIS (EBRI Issue Brief No. 195, 1998) (using model to show cost, benefit, national saving, and growth projections under five options for reforming Social Security, including two that would partially privatize system). See also CRAIG COPELAND ET AL., SOCIAL SECURITY REFORM (EBRI Issue Brief No. 210, June 1999) (describing updated application of model); MUELLER, *supra* note 37 (using the SSASIM model to find scaled back version of current Social Security system almost always superior to privatized or partially privatized system).

For criticisms of the model and its applications, see, e.g., *CATO Institute Study Rejects Finding of Prior Report Panning Private Accounts*, 26 PENS. & BEN. REP. (BNA) 2827, 2827 (1999) (describing criticisms of Mueller's study); *Congressional Aides Criticize EBRI Analysis of Social Security Plans*, 26 PENS. & BEN. REP. (BNA) 1645, 1645 (1999) (describing criticisms of EBRI Issue Brief No. 210).

47. Of course, other elements of the current system, such as the regressive manner in which the benefits are financed (flat tax subject to a wage cap) and the limitation of the number of years of employment that are taken into account in calculating benefits,

*A. Investment Risk*

This section explains why women, minorities, and lower-income workers are likely to be relatively disadvantaged by partial privatization's shift of investment risk from the government to workers. With respect to women, the section focuses on women in their roles as workers earning their own social security benefits.<sup>48</sup> To the extent that women workers are married to higher-wage white males and rely on them for investment advice and retirement income, the analysis in this section may not apply to them.

---

may also affect its redistribution. See Moore, *supra* note 3, § III.

48. Cf. Karen C. Burke & Grayson M.P. McCouch, *The Impact of Social Security Reform on Women's Economic Security*, 16 N.Y.L. SCH. J. HUM. RTS. 375, 375 (1999) (referring to "[w]omen as workers, wives, and widows"); see also *infra* Part III(E)(1) (discussing how partial privatization is likely to effect women in their capacity as wives and widows relying on their husbands' earnings for their social security benefits).

## 1. Investment Experience

Members of all three of the at-risk groups, women,<sup>49</sup> minorities,<sup>50</sup> and lower-income workers,<sup>51</sup> tend to save less for retirement than do higher-

49. For example, only 27% of women have over \$100,000 in their 401(k) plans, compared with 43% of men, while 33% of women have under \$25,000 in their 401(k) plans, compared with only 18% of men. See Juliette Fairley, *Spinster Boomers Face Rough Retirement*, INVESTOR'S BUS. DAILY, Feb. 20, 1998, at B1 ("To make matters worse, 27% of women have not made any financial plans for retirement.") (based on study done by the National Center for Women and Retirement Research); see also SHIRLEY & SPIEGLER, *supra* note 17 (according to a 1993 telephone survey by Merrill Lynch Consulting only 30% of women between the ages of 25 and 65 were saving for retirement compared with 47% of men of the same ages); Donna Gardner Schumell, *Increased Focus on Women as Financial Service Consumers*, 135 TR. & EST. 19 (1996) ("A recent survey by Merrill Lynch reported that only 63 percent of women save for retirement compared to 71 percent of men, and even then, save only half of what men save.").

50. For example, only 29% of families headed by a nonwhite or Hispanic held retirement accounts compared with 47% of families headed by a white non-Hispanic, and smaller percentage of families headed by a nonwhite or Hispanic held every type of financial asset, from transaction accounts to life insurance, than did families headed by a white non-Hispanic. See Arthur B. Kennickell et al., *Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances*, FED. RESERVE BULL. 1, 9 (1997) (data based on 1995 Survey of Consumer Finances); see also *Hearing on Pension Issues: Before the Subcomm. on Oversight of the House Ways and Means Comm.*, 105th Cong. (1998) (statement of Jeffrey R. Lewis, Exec. Dir., Heinz Family Philanthropies) (according to poll by Heinz Foundation and SunAmerica Corporation of women aged 25-55, "75% of African-American women and 59% of Hispanic women report that they usually have little or no money left after paying their bills to save for retirement."); MELVIN L. OLIVER & THOMAS M. SHAPIRO, *BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY* 166 (1995) (showing that for every occupational background, blacks have substantially lower net worth than their white counterparts); *Hispanic Group La Raza Urges More Involvement in the Reform Debate*, 25 PENS. & BEN. REP. (BNA) 2222, 2223 (1998) (according to Employee Benefit Research Institute's 1998 Retirement Confidence Survey, Hispanics were least likely among all racial/ethnic groups to have begun to save or invest for retirement); Humberto Cruz, *Hispanics Need to Focus on Financial Planning*, SUN-SENTINEL (Fort Lauderdale), Nov. 21, 1997, at 23 ("Among the top 10 percent of elderly Hispanics in terms of income, the average household had liquid assets as low as \$14,600 in 1995, compared with \$172,500 for whites, the most recent figures available.").

51. See, e.g., U.S. GENERAL ACCOUNTING OFFICE, 401(K) PENSION PLANS: MANY TAKE ADVANTAGE OF OPPORTUNITY TO ENSURE ADEQUATE RETIREMENT INCOME, GAO REPORT TO THE CHAIRMAN, SUBCOMM. ON SOCIAL SECURITY, HOUSE COMM. ON WAYS AND MEANS GAO/HEHS-96-176 5-6 & app. II, at 19, 22 & 23 (1996) [hereinafter OPPORTUNITY] (finding that not only are higher-income workers far more likely to be covered by a pension plan than lower-income workers but when covered by a 401(k) plan, higher-income workers tend to contribute a larger percentage of their salary than

income white males. As a result, members of the three at-risk groups have less investment experience than do higher-income white males.<sup>52</sup> Common sense suggests that the relative lack of investment experience of the at-risk groups is

---

do lower-income workers) (based on data from 1992 Survey of Consumer Finances and the Health and Retirement Survey); Kennickell et al., *supra* note 50, at 6 tbl.3 (finding 1995 median net worth of white families \$84,700 compared with \$6,800 for nonwhite or Hispanic families); James M. Poterba et al., *401(k) Plans and Tax-Deferred Saving*, in *STUDIES IN THE ECONOMICS OF AGING* 105, 108 (David A. Wise ed., 1994) (using data from 1984, 1985, and 1986 panels of the Survey of Income and Program Participation and May 1983 and 1988 Current Population Surveys and 1989 Survey of Consumer Finances shows that participation in 401(k) plans and IRAs steadily increases with income and that account balances also generally increase with income though not entirely in lock step).

According to a survey released on April 5, 1998 by the Washington group, Americans Discuss Social Security, people with annual incomes under \$40,000, particularly blacks and Hispanics, have difficulty saving for retirement. It found that only 36% of people with incomes of less than \$20,000 per year have started to save for retirement, while 68% of people with annual incomes between \$20,000 and \$40,000 have started to save. Eighty-two percent of those with annual incomes between \$40,000 and \$60,000 have started saving, while 92% with annual incomes greater than \$59,000 have started to save for retirement. The survey further found that while most blacks and Hispanics with at least \$40,000 in annual income save for retirement to the same extent as whites with similar incomes, as incomes decrease, the saving habits of whites and minorities diverge. Just 57% of non-whites with incomes between \$20,000 and \$40,000 annually have set aside any money for retirement, while 71% of white individuals with similar incomes have saved for retirement. *Half of Adults Expect to Benefit from Social Security, Survey Says*, 25 PENS. & BEN. REP. (BNA) 808, 808 (1998).

52. See OPPORTUNITY, *supra* note 51, app. II, at 19 & 23 (using data from 1992 Survey of Consumer Finances and Health and Retirement Survey, finding that black workers nearing retirement age slightly more likely to be without pension coverage than white workers and black workers more likely to be covered by defined benefit plan (that rarely, if ever, requires workers to make investment decisions) while white workers more likely to participate in 401(k) plan (that often requires workers to make investment decisions)); Kathy Catrambone, *Women Face Barriers in Retirement*, PENS. & INVEST. June 1, 1998, at 34 (noting that Dreyfus's 1997 Gender Investment Comparison Study of households with income greater than \$50,000 found that "almost 50% of female respondents claim to lack the time, money and knowledge necessary to invest for retirement"); J. Engen, *Brokerage Services: NDB's Affinity Relationship Brings On-Line Trading to Professional Women*, AM. BANKER, June 3, 1998, at 13A (noting that in a 1997 study commissioned by Oppenheimer Funds, Inc., 62% of women in married households manage the checkbook while only 15% manage investments); Betty A. Rubin, *Tapping into the Fast-Growing Women's Market*, PRIVATE ASSET MGMT., July 3, 1999, at 9 ("A nationwide study of women between the ages of 35-54 conducted by Executive Female Magazine revealed that 71% said they did not know how to invest. More than a third of the respondents had never ventured forth to make an investment decision.").



likely to result in their receiving lower rates of return under a partially privatized Social Security system.<sup>53</sup>

Investing wisely requires knowledge,<sup>54</sup> or at least good advice, and those with less investment experience are likely to have less investment knowledge and less access to good advice.<sup>55</sup> Results from a 1993 Merrill Lynch household survey confirm that men generally perform better than women, whites better than blacks, and higher-income respondents better than lower-income respondents in tests on financial knowledge.<sup>56</sup> The relative lack of investment experience and knowledge of the at-risk groups suggests that they are likely to enter a partially privatized Social Security system at a disadvantage.<sup>57</sup>

---

53. Cf. B. Douglas Bernheim, *Financial Illiteracy, Education, and Retirement Saving*, in *LIVING WITH DEFINED CONTRIBUTION PENSIONS* 38, 43 (Olivia S. Mitchell & Sylvester J. Schieber eds., 1998) (stating that "existing literature demonstrates that most Americans know little about managing personal finances and their choices reflect their ignorance").

54. Cf. C. COLBURN HARDY, *DUN & BRADSTREET'S GUIDE TO YOUR INVESTMENTS* 17 (21st ed. 1976-1977) ("There is no rule book or mysterious key to success in the stock market. Whether investment or speculation, it's a business of common sense, faith, courage, knowledge, and patience—with a reasonable amount of luck.").

55. See John Williamson, *Should Women Support the Privatization of Social Security?*, *CHALLENGE*, July 17, 1997, at 97. Williamson states:

Partial privatization would offer the most benefits to those who are in a position to obtain good investment advice. Such advice is more available to the affluent than to low-income households. Because women are more likely to be living in low-income households, they generally have less access to good investment advice.

*Id.*

56. Bernheim, *supra* note 53, at 47-48 (noting that "[d]ifferences based on gender and race are statistically significant, even holding other variables (such as education and earnings) constant . . . . [F]inancial scores rise with earnings, and this increase is statistically significant").

57. Of course, providing investment education may help level the playing field. See *infra* Part III(A)(3).

## 2. Risk Aversion

To the extent that they do save for retirement, lower-income workers tend to be more risk averse<sup>58</sup> than higher-income workers.<sup>59</sup> Since women and minorities (other than Asians)<sup>60</sup> tend to earn lower wages,<sup>61</sup> the fact that lower-income workers tend to be more risk averse suggests that women and minorities may also tend to be more risk averse.

---

58. "A person is risk averse if she prefers a certain return on an investment to an uncertain return with an expected value equal to the certain return." Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 457 n.76 (1992). "Given a choice between a 50% chance of losing \$100 and the certainty of losing \$50, a risk averse person would choose to lose \$50. A risk preferring person would rather take the 50% chance of losing \$100, while a risk neutral person would have no preference." Jill Gaubling, Note, *Race, Sex, and Genetic Discrimination in Insurance: What's Fair?*, 80 CORNELL L. REV. 1646, 1651 n.22 (1995).

59. See, e.g., OPPORTUNITY, *supra* note 51, at 24 (showing that higher-income workers tend to invest more heavily in stocks than do lower-income workers based on data from the 1992 Survey of Consumer Finances and the Health and Retirement Survey); Vickie L. Bajtelsmit & Jack L. VanDerhei, *Risk Aversion and Pension Investment Choices*, in POSITIONING PENSIONS FOR THE TWENTY FIRST CENTURY 45, 60 (Michael S. Gordon et al. eds., 1997) (finding lower-income workers tend to be more risk averse than higher-income workers according to a study based on a sample of 20,000 active management participants for a single, large U.S. employer); Gordon P. Goodfellow & Sylvester J. Schieber, *Investment of Assets in Self-Directed Retirement Plans*, in POSITIONING PENSIONS FOR THE TWENTY FIRST CENTURY 67 (Michael S. Gordon et al. eds., 1997) (pooling administrative records on slightly more than 36,000 participants drawn from 24 defined contribution plans holding nearly \$1.4 billion in total assets, finding higher-wage workers somewhat more aggressive in their investments than lower-wage workers); Richard P. Hinz et al., *Are Women Conservative Investors? Gender Differences in Participant-Directed Pension Investments*, in POSITIONING PENSIONS FOR THE TWENTY FIRST CENTURY 91 (Michael S. Gordon et al. eds., 1997) (finding higher-income participants significantly more likely to contribute to a common stock fund than lower-income counterparts based on 1990 Thrift Savings Plan data); PAUL YAKOBOSKI & JACK VANDERHEI, WORKER INVESTMENT DECISIONS: AN ANALYSIS OF LARGE 401(K) PLAN DATA (EBRI Issue Brief No. 176, 1996) (study of asset allocations of 401(k) plans of three large employers provides some evidence that lower-income workers tend to be more risk averse than higher-income workers).

60. See *supra* note 18 and accompanying text.

61. See, e.g., U.S. BUREAU OF THE CENSUS, MONEY INCOME FOR THE UNITED STATES: 1997 CURRENT POPULATION REPORTS, CONSUMER INCOME P60-200 vii tbl.A, 28-29 tbl.7 (1998) (reporting that in 1997 the median earnings of full-time, year-round working women was 74% of that of men (\$24,973 versus \$33,674) and that the median income of white-non-Hispanic men was \$36,118, black men was \$26,897, and men of Hispanic origin was \$21,799 while the median income of white-non-Hispanic women was \$26,470, black women was \$22,764, and women of Hispanic origin was \$19,676).

Examining gender differences in investment behavior is a relatively new field of academic inquiry,<sup>62</sup> and examinations of investment behavior based on race are even rarer.<sup>63</sup> Nevertheless, a number of recent studies confirm that women<sup>64</sup> and blacks<sup>65</sup> tend to be more risk averse than men and whites. Moreover, some of the studies show that women<sup>66</sup> and blacks<sup>67</sup> (at least black

62. For a survey of the literature, see Vickie Bajtelsmit & Alexandra Bernasek, *Why Do Women Invest Differently than Men*, 7 COUNSELING & PLANNING 1 (1996).

63. See U.S. GENERAL ACCOUNTING OFFICE, SOCIAL SECURITY AND MINORITIES: CURRENT BENEFITS AND IMPLICATIONS FOR REFORM GAO/T-HEHS-99-60 5 (1999) [hereinafter IMPLICATIONS] (noting that no research had previously been done on minorities' investment patterns).

64. See U.S. GENERAL ACCOUNTING OFFICE, SOCIAL SECURITY REFORM: IMPLICATIONS FOR WOMEN'S RETIREMENT INCOME, GAO REPORT TO THE RANKING MINORITY MEMBER, SUBCOMM. ON SOCIAL SECURITY, HOUSE COMMITTEE ON WAYS AND MEANS GAO/HEHS-98-42 (1997) [hereinafter WOMEN'S RETIREMENT INCOME] (using data from Health and Retirement Study and controlling for demographic characteristics, wealth, and income, finding that, on average, the ratio of riskier assets to total assets held by men was eight percentage points higher than the same ratio for women); OPPORTUNITY, *supra* note 51, at 24 (using data from the 1992 Survey of Consumer Finances and the Health and Retirement Survey, finding that female workers tend to be more risk averse or conservative investors than male workers); Bajtelsmit & VanDerhei, *supra* note 59, at 60 (suggesting, in a study based on sample of 20,000 active management participants for a single, large U.S. employer, that women are more likely than men to invest in "less risky" fixed-income assets rather than "more risky" equities. (Bajtelsmit and VanDerhei, however, do not view their study as establishing conclusive evidence of gender differences in risk aversion because they did not have complete information on marital status and other household wealth and income)); Hinz et al., *supra* note 59, at 91 (finding men significantly more likely to hold risky assets than women even when salary and other family income are held constant based on 1990 survey data of participants in Thrift Savings Plan); Nancy Ammon Jianakoplos & Alexandra Bernasek, *Are Women More Risk Averse?*, 36 ECON. INQUIRY 620 (1998) (finding single women relatively more risk averse than single men and married couples based on data from the 1989 Survey of Consumer Finances on allocation of total household wealth); William B. Riley Jr. & K. Victor Chow, *Asset Allocation and Individual Risk Aversion*, 48 FIN. ANALYSTS J. 32 (1992) (finding, based on empirical study of individual asset allocation and risk behavior using financial data for large random sample of U.S. households, women are slightly more risk averse than men and risk aversion decreases as income increases).

65. IMPLICATIONS, *supra* note 63, at 5 (finding that, controlling for income and education, black IRA holders tend to be somewhat more conservative investors than whites based on national survey data); Andrew F. Brimmer, *Issues in the Black Community: Income, Wealth, and Investment Behavior in the Black Community*, 78 AM. ECON. REV. 151, 155 (1988) (showing that proportionately more whites than blacks in the \$30,000 to \$40,000 income bracket participated in the stock market, and that the blacks who did participate tended to invest more heavily in securities issued by companies with the highest credit ratings).

66. See WOMEN'S RETIREMENT INCOME, *supra* note 64, at 9-10; Hinz et al., *supra*

men)<sup>68</sup> tend to be more risk averse, even when income and wealth are taken into account. The evidence with respect to blacks, however, does not extend to all income groups,<sup>69</sup> and a study that included Hispanics found that Hispanics may be no more risk averse than whites when income is taken into account. It may also be worth noting that two recent studies funded by the mutual fund industry found that women tend to be no more risk averse than men.<sup>70</sup>

---

note 59, at 92.

67. See IMPLICATIONS, *supra* note 63, at 5; Brimmer, *supra* note 65. In addition, a January 1998 survey by Jankelovick Partners shows that, controlling for income, blacks tend to be more conservative investors than whites. Specifically, comparing the investment habits of 500 blacks and 732 whites, the study found that black households with incomes exceeding \$50,000 invest more conservatively than do similar white households.

Blacks, the survey said, are less likely to trust investment advisers, had less exposure to the stock market in their upbringing and have a cultural preference for real estate and insurance over stock . . . 46% of blacks surveyed consider real estate the best investment overall, while 50% of whites said stocks were the best vehicles for financial growth. Also according to the survey, just 57% of blacks reported having any money in the stock market compared with 81% of whites. . . . In fact, 63% of the blacks surveyed described themselves as conservative investors, compared with 53% of whites.

Peter Alan Harper, *Survey: Under-investing in Stocks Leaves Blacks with Less for Retirement*, LEXINGTON HERALD-LEADER, Apr. 19, 1999, at D2; see also George Raine, *Urging Blacks to be Bullish; Seminars to Stress More Aggressive Investment Strategies*, SAN FRANCISCO EXAM'R, Apr. 19, 1998, at B1 (noting that blacks have "culturally imbued conservative approach to finance"). For additional discussions of this survey, see *Survey Reveals Differences Between African-American, White Investors*, 25 PENS. & BEN. REP. (BNA) 873 (1998); Peter Alan Harper, *Survey Shows Blacks and Whites Tend to Invest Money Differently*, WASH. POST, Apr. 9, 1998, at C5; *Survey Finds Racial Divide in Attitudes Toward Investment Study: Black Households Are Less Likely Than Whites To Own Stocks, Preferring Real Estate and Insurance*, L.A. TIMES, Apr. 9, 1998, at D1.

68. See Brimmer, *supra* note 65, at 155 (noting that brokers report that among black investors young women are much more active in the stock market than are black men in the same income and age categories); Jianakoplos & Bernasek, *supra* note 64, at 627 (finding that single black women are willing to hold a larger proportion of risky assets on average than single white women, black single men, and black married couples).

69. The Brimmer study showed that blacks with incomes in the range of \$40,000 to \$50,000 tend to invest in the market in a similar manner to whites with that range of income. See Brimmer, *supra* note 65, at 155.

70. See *Women as Aggressive as Men with 401(k)s, Study Finds* <<http://www.watsonwyatt.com/homepage/Pres-Rel/MAY98/401k-tm.html>>; see also Diane Harriscover, *Why More Women Say . . . I Don't Need Your Money, Honey; Women Today are Investing More and Getting Better Returns*, MONEY, Nov. 1996, at 146.

To the extent that members of the at-risk groups tend to be more risk averse, they are likely to receive lower rates of return under a partially privatized Social Security system. Capital market history shows that as investment risk increases so does investment return. For example, U.S. Treasury bills, about the safest of investments,<sup>71</sup> provided an average nominal return of 3.7% over the period of 1926 to 1994.<sup>72</sup> In contrast, common stocks, which are much riskier assets,<sup>73</sup> provided an average nominal return of 12.2% over the same period.<sup>74</sup> Basic financial theory teaches that that differential, or risk premium, rewards investors for accepting higher risk.<sup>75</sup> Thus, to the extent that the at-risk beneficiaries are unwilling or unable to assume greater risks, they should expect lower returns.<sup>76</sup>

### 3. Investment Education

By providing workers with investment education, a partially privatized Social Security system could offset some of the risk of more vulnerable

---

Women are investing much more assertively than they have in the past. National studies of both 401(k) investors and mutual fund holders show that women are shifting their assets out of savings accounts that simply preserve their principal and into growth-oriented investments like individual stocks and equity mutual funds. Roughly equal proportions of men (74%) and women (71%) fundholders now invest in stock funds, according to the Investment Company Institute, the mutual fund trade organization. And both sexes allocate nearly equal percentages of their portfolios to equities: 47% for men, 46% for women.

*Id.*

71. See RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 143-44 (5th ed. 1996).

72. *Id.* at 146.

73. The standard deviation of the market portfolio, which is generally represented by the S & P's composite index, is about 20% per year. *Id.* at 152.

74. *Id.* at 146.

75. *Id.* at 180. Brealey and Myers stated:

Wise investors don't take risks just for fun. They are playing with real money. Therefore, they require a higher return from the market portfolio than from Treasury bills. The difference between the return on the market and the interest rate is termed the *market risk premium*. Over a period of 69 years the market risk premium ( $r_m - r_f$ ) has averaged 8.4 percent a year.

*Id.*; see also ROBERT A. HAUGEN, *MODERN INVESTMENT THEORY* 207 (4th ed. 1997) ("[T]he expected return on a stock is equal to the risk-free rate (compensating investors for delaying consumption over the planning horizon), plus a risk premium (compensating them from taking on the risk associated with the investment).").

76. See, e.g., Hinz et al., *supra* note 59, at 99 (estimating that after 35 years of participation in the Federal Thrift Savings Plan at historical yields and identical contributions, women would have pension portfolios that are 16% smaller than those of men because of women's relative risk aversion).

beneficiaries receiving lower rates of return.<sup>77</sup> Efforts have been made on a variety of fronts to educate Americans about retirement savings in recent years.<sup>78</sup> For example, Congress recently enacted the Savings Are Vital to Everyone's Retirement (SAVER) Act,<sup>79</sup> which is intended, among other things, "to advance the public's knowledge and understanding of retirement savings and its critical importance to the future well-being of American workers and their families."<sup>80</sup> Similarly, employers have increasingly made efforts to provide their employees with retirement education.<sup>81</sup> Financial firms and civic organizations have also

---

77. Cf. Transcript #98040902FN-L08 for Show: Take It Personally (Apr. 9, 1988) (noting that misconceptions and misperceptions of African-Americans that lead to their investing more conservatively can be overcome by more education and more African-American role models). For an extensive discussion of the importance of investor education and the role the government should play in providing that education, see James A. Fanto, *We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education*, 49 CASE W. RES. L. REV. 105 (1998). See also WOMEN'S RETIREMENT INCOME, *supra* note 64, at 14 (noting that it is not clear who would provide investment education in the case of individual retirement savings accounts under a privatized Social Security system); *Social Security: SSA's Apfel Promotes Clinton Surplus Plan, Cool to Private Account Carve-Out Proposals*, 26 PENS & BEN. REP. (BNA) 293, 294 (1999) (noting that SEC Commissioner Paul Carey has said that "investor education should be a key component of any steps in th[e] direction [of creating individual accounts], especially since many potential account holders will not have previous investing experience").

78. See Fanto, *supra* note 77, at 108.

79. Pub. L. No. 105-92, 111 Stat. 2139 (1997) (codified at 29 U.S.C. §§ 1146-1147 (Supp. III 1997)).

80. 29 U.S.C. § 1146 (Supp. III 1997). For a more detailed discussion of the SAVER Act and other governmental efforts to educate the public as well as a critique of some of those efforts, see Fanto, *supra* note 77, at 146-78.

81. About 62% of employers surveyed in the KPMG Peat Marwick 1998 Retirement Benefits Survey said that they offered their employees financial education on saving and investing for retirement, up from 46% in 1995. See *Retirement Planning: Employers Not Planning to Increase Benefits to Cover Any Social Security Reductions*, 25 PENS. & BEN. REP. (BNA) 1859, 1869 (1998); see also B. Douglas Bernheim, *Financial Illiteracy, Education, and Retirement Saving*, in LIVING WITH DEFINED CONTRIBUTION PENSIONS: REMAKING RESPONSIBILITY FOR RETIREMENT 38, 39 (Olivia S. Mitchell & Sylvester J. Schieber eds., 1998) (noting that as of 1994, 88% of large employers offered some form of financial education, more than two-thirds of which added these programs after 1990). For discussions of the types of education employers provide and the impact of the various types of education, see, for example, CAN WE SAVE ENOUGH TO RETIRE? PARTICIPANT EDUCATION IN DEFINED CONTRIBUTION PLANS (EBRI Issue Brief No. 160, 1995) [hereinafter ISSUE BRIEF NO. 160]; PARTICIPANT EDUCATION: ACTIONS AND OUTCOMES (EBRI ISSUE BRIEF NO. 169, 1996) [hereinafter ISSUE BRIEF NO. 169]; YAKOBOSKI & VANDERHEI, *supra* note 59.

increased efforts to provide individuals with investment education,<sup>82</sup> and have directed some of those efforts specifically at women<sup>83</sup> and minorities.<sup>84</sup>

Experience with employer-provided retirement education suggests that educational efforts can and do make a difference. First,<sup>85</sup> studies show that employer-provided retirement education increases both the number of employees who participate in retirement savings plans and the amount that they save in these programs.<sup>86</sup> More importantly, a couple of recent surveys<sup>87</sup> reveal that

82. See Fanto, *supra* note 77, at 140-46 (describing and critiquing investor education provided by the private market).

83. See Juliette Fairley, *Spinster Boomers Face Rough Retirement*, INVESTOR'S BUS. DAILY, Feb. 20, 1998, at B1. Fairley stated:

Scudder Kemper has used the study in developing a series of seminars and how-to manuals geared toward helping women prepare for retirement. Lin Coughlin, a managing rector of Scudder Kemper, says she's working on a brochure for women that tells them what they need to do to take charge of their financial futures.

*Id.*; see also Engen, *supra* note 52, at 13A (discussing internet investment site designed to focus on and serve women); Janet L. Fix, *Building Nest Egg Often Hard for Women, Minorities*, ORANGE COUNTY REG., July 12, 1998, at K01 ("Increasingly, women, if not minorities, are being targeted as a group that needs or wants education on saving and investment. More investment companies are targeting women. Recently, Vanguard Group published a booklet, 'Women and Investing: A step-by-step guide to your personal finances.'").

84. Maria T. Padilla, *Minority Interest in Market Grows; But It's Been a Hard Sell for Wall Street*, SAN DIEGO UNION-TRIB., Dec. 7, 1997, at I2. Padilla noted:

More minority professionals and groups are trying to change the way minorities think about money by teaching their brethren about investing. For example, Orlando's African-American, Hispanic and Asian-American chambers of commerce have sponsored financial seminars for members. 'We are trying to get the small-business entrepreneur to be aware there is more to saving money,' said Lita Martija of the Asian American Chamber of Commerce.

*Id.*; see also Humberto Cruz, *No-strings Seminar Fills Need for Blacks*, LEXINGTON HERALD-LEADER, Oct. 11, 1998, at F1 (discussing free personal-investment planning seminar sponsored by Nova Southeastern University and the Broward YMCA at the Y's L.A. Lee Branch in a predominantly black section of Fort Lauderdale, Fla.); Raine, *supra* note 67, at B-1 (describing nationwide seminars, organized by Coalition of Black Investors, to discuss market principles and opportunities with blacks).

85. Of course, since most partial privatization proposals mandate participation at a particular rate, these studies are not directly relevant.

86. See, e.g., PATRICK J. BAYER ET AL., THE EFFECTS OF FINANCIAL EDUCATION IN THE WORKPLACE: EVIDENCE FROM A SURVEY OF EMPLOYERS (National Bureau Econ. Research Working Paper No. 5655, 1996) (finding in study of retirement education provided by large employers that frequent provision of retirement seminars positively affects participation in and contributions to 401(k) plans, particularly among lower-paid employees); B. DOUGLAS BERNHEIM & DANIEL M. GARRETT, THE DETERMINANTS AND CONSEQUENCES OF FINANCIAL EDUCATION IN THE WORKPLACE: EVIDENCE FROM A

employer-provided education can and does impact allocation decisions,<sup>88</sup> and

SURVEY OF HOUSEHOLDS (National Bureau of Econ. Research Working Paper No. 5667, 1996). Based on household survey data collected by Merrill Lynch in the fall of 1994, Bernheim & Garrett found that:

[A]vailability of retirement education also increases the overall rate of saving by 1.65 percentage points, and raises the rate of saving for retirement by just under one percentage point. Both effects are large relative to median rates of saving for those who do not have access to retirement education in the workplace (6% and 3% respectively) and both are statistically significant at high levels of confidence.

*Id.*; see also Bernheim, *supra* note 53, at 61-62 (finding in a study based on plan sponsors who attended a Merrill Lynch conference on 401(k) plans that controlling for other factors, participation in 401(k) plans is, on average, 18.5% points higher in firms that offer retirement education than in firms that do not offer such education); Robert L. Clark & Sylvester J. Schieber, *Factors Affecting Participation Rates and Contribution Levels in 401(k) Plans*, in *LIVING WITH DEFINED CONTRIBUTION PENSIONS: REMAKING RESPONSIBILITY FOR RETIREMENT* 69, 74, 85 (Olivia S. Mitchell & Sylvester J. Schieber eds., 1998) (study based on data collected by Watson Wyatt of 401(k) plans for 19 firms ranging from 700 to 10,000 employees finds that quality of communication regarding 401(k) plans affects participation rates; providing generic materials in addition to required forms and statement increases probability of worker participating in plan by 15%; providing information specifically tailored for company's own plan increases probability of worker participating in plan by 21%); ISSUE BRIEF NO. 160, *supra* note 81, at 18-19 (according to a 1994 survey by Employee Benefits Research Institute and Matthew Greenwald and Associates, 33% of the workers who reported reading educational material provided by their employer reported that the materials led them to increase the amount of their contributions; according to the survey, 92% of those receiving educational material reported reading it); PAUL YAKOBOSKI & JENNIFER DICKEMPER, *INCREASED SAVING BUT LITTLE PLANNING: RESULTS OF THE 1997 RETIREMENT CONFIDENCE SURVEY* 14 (EBRI Issue Brief No. 191, 1997) (noting that "[i]n a Rogers Casey/Institute of Management and Administration (IOMA) survey, 75 percent of responding 401(k) plan sponsors said that participation rates in their plan increased due to participant communication").

87. Unfortunately, there have been few studies on how retirement education affects allocation. See *WOMEN'S RETIREMENT INCOME*, *supra* note 64, at 14 (noting that few, if any, studies have examined how education affects the allocation decisions of 401(k) participants); cf. Bernheim & Garrett, *supra* note 88, at 4 (noting that due to data limitations they were unable to study the effects of education on portfolio allocation).

88. ISSUE BRIEF NO. 169, *supra* note 81, at 7. The authors of Issue Brief No. 169 noted that according to the 1995 Employee Benefits Research Institute/Matthew Greenwald and Associates Retirement Confidence Survey, almost half of workers using educational material provided by their employer reported that they changed their allocation decisions as a result of the educational material. The effect was slightly more likely among those with a high school diploma or less than among workers with more education. "Interestingly, while workers with less formal education (i.e., a high school degree or less) are less likely than their peers to utilize educational material that is provided, when they do use the material, they seem to be equally or more likely than their peers to alter their behavior as a result." ISSUE BRIEF NO. 169, *supra* note 81, at 7.



that 401(k) participants are making better investment choices as a result of additional education and growing sophistication.<sup>89</sup>

Thus, furnishing investment education could help all workers, including the at-risk populations, to invest wisely. Providing additional education, however, is unlikely to eliminate all differences between the rates of return at-risk beneficiaries and higher-income white males are likely to receive.

Basic financial theory teaches that not only can investors who take on greater risk expect greater returns,<sup>90</sup> but investors who accept higher risk are not guaranteed higher returns. Investment risk means that future returns are unpredictable;<sup>91</sup> the greater the chance of low returns, the riskier the investment.<sup>92</sup>

Not all Social Security beneficiaries are equally able to handle investment risk. Some beneficiaries rely more heavily on Social Security for their retirement income than do others. As a whole, women<sup>93</sup> and minorities<sup>94</sup> tend to

Similarly, the authors of Issue Brief No. 160 noted that according to the 1994 Employee Benefits Research Institute/Matthew Greenwald and Associates Retirement Confidence Survey, of the 92% of respondents who reported reading the educational material or seminars provided by their employers, 44% reported that they changed the allocation of their money among the available options as a result of relying on the material. ISSUE BRIEF NO. 160, *supra* note 81, at 19; *see also* YAKOBOSKI & DICKEMPER, *supra* note 86, at 14 (stating that "the RCS found that among users of educational material, 49 percent report that it led them to change the allocation of their money among the investment options offered").

89. *Workers Gain Growing Number of Options in Employer-Sponsored Section 401(k) Plans*, 25 PENS. & BEN. REP. (BNA) 435 (1998) (noting that in a report Hewitt Associates, 401(k) Trends and Experience 1997, only 40% of employers felt their plan participants were investing too conservatively in 1997, compared with 53% in 1995).

90. *Cf.* HAUGEN, *supra* note 75, at 176 ("Collectively, you would expect the payoffs to these risk variables to be positive, with stocks having greater exposures to the variety of risk attributes having greater expected rates of return."); ISSUE BRIEF NO. 160, *supra* note 81, at 12 (comparing risk and return of portfolios with stock, bonds, t-bills, and cash and noting that portfolio consisting of 100% cash would be expected to provide smallest degree of volatility risk at price of lowest expected return).

91. BREALEY & MYERS, *supra* note 71, at 166; *see also* EUGENE F. BRIGHAM, FINANCIAL MANAGEMENT: THEORY AND PRACTICE 119 (3d ed. 1982) ("Investment risk, then, is related to the probability of low or negative returns—the greater the chance of low returns, the riskier the investment.").

92. *See* BRIGHAM, *supra* note 91, at 119.

93. Nonmarried women aged 65 or older relied on Social Security for 51% of their total money income in 1996, while nonmarried men of the same age relied on Social Security for just under 40% of their total money income that year. U.S. DEP'T OF HEALTH & HUMAN SERVICES, INCOME OF THE POPULATION 55 OR OLDER, 1996, at 124 tbl.VII.6 (1996).

94. White aged units 65 or older relied on Social Security for 40% of their total money income in 1996 while black aged units 65 or older relied on Social Security for 42% of their total money income and aged units 65 or older of Hispanic origin relied on

rely somewhat more heavily on Social Security for their retirement income than do men and nonminorities. In addition, older individuals with lower incomes rely on Social Security for a significantly larger percentage of their income in retirement than do those with higher incomes.<sup>95</sup>

The more a Social Security beneficiary relies on Social Security for her retirement income, the less she is able to bear investment risk on that income. Thus, Social Security beneficiaries who rely more heavily on Social Security for their retirement income may be well-advised to invest their social security individual account more conservatively than those beneficiaries who have other sources of retirement income.<sup>96</sup> Accordingly, to the extent that individual members of the at-risk groups rely disproportionately on Social Security for their retirement income, they may be well-advised to invest more conservatively than higher-income white males and thus expect lower rates of return than higher-income white males.<sup>97</sup> On the other hand, to the extent that individual members

Social Security for 45% of their total money income that year. *Id.* at 123 tbl.VII.4. White aged units 65 or older received a larger share of their retirement income from private pensions and annuities and income from assets than did similarly aged blacks and Hispanics while blacks and Hispanics relied on earnings and public assistance for a larger percentage of their retirement income than did whites. *Id.*

95. Aged units in the two lowest quintiles of income relied on Social Security for more than 80% of their total money income in 1996, while aged units in the highest quintile relied on Social Security for little more than 20% of their total money income that year. *Id.* at 123 tbl.VII.5; *see also* ALAN L. GUSTMAN ET AL., PENSION AND SOCIAL SECURITY WEALTH IN THE HEALTH AND RETIREMENT STUDY 41, 75 tbl.15 (NBER Working Paper No. 5912, 1997). Gustman et al. stated:

[S]ocial security wealth accounts for a declining portion of wealth as average wealth increases, falling from over 100 percent of net wealth for the bottom five percent of households (counting those with negative wealth), and falling smoothly as one proceeds up the wealth distribution to 7 percent of wealth for the top five percent of the distribution.

*Id.*

96. *See Practical Issues Raised by Reforming Social Security With a System Including Personal Security Accounts: Testimony Before House Ways and Means Comm.*, 105th Cong. (1998) (statement of Sylvester J. Schieber), available in 1998 WL 327364 (noting that study of 401(k) plans found that workers at low-earnings levels invested more conservatively than those with higher incomes and contending that the portfolio allocations "are not wildly off base and the variations by earnings and age level follow a rational pattern that is consistent with the way educated investors would invest"); Adler, *supra* note 58, at 457 n.76 (finding risk aversion reasonable and declaring "[c]onsider a worker on whom her family relies for its sustenance. Although there are exceptions, the worker is unlikely to gamble her entire wealth on an investment that has an equal chance of doubling her investment or dissipating it entirely."); Kijakazi, *supra* note 17, at 9 (stating that "lower-income groups have less investment experience and would be more likely to invest in an overly conservative manner because they could not afford to expose the funds in their accounts to much risk").

97. On the other hand, to the extent that these higher risk groups can rely on

of the at-risk groups do not rely disproportionately on Social Security for their retirement income, investment education should teach them to be less risk averse, and they should not expect lower rates of return if they act in accordance with that education.

#### 4. Conclusion

Although a partially privatized Social Security system would subject all workers to investment risk, there is reason to believe that the at-risk beneficiaries would not be able to bear that investment risk as well as higher-income white males. First, the at-risk groups tend to have less investment experience than do higher-income white males. Absent education, this relative lack of experience is likely to lead to their receiving lower rates of returns under a partially privatized Social Security system. Second, to the extent that the more vulnerable populations have investment experience, they tend to be more risk averse than higher-income white males. This relative risk aversion is likely to lead to their receiving lower rates of return.

Providing all workers with investment education may help to level the playing field but is not likely to protect all members of the at-risk groups from receiving lower rates of return under a partially privatized Social Security system. To the extent that they rely disproportionately on Social Security for their retirement income, the at-risk beneficiaries may be well-advised to remain relatively more risk averse and thus expect lower rates of return under a partially privatized system. While these differential returns may be consistent with Social Security's goal of individual equity,<sup>98</sup> they hardly appear consistent with its social adequacy goal; that is, its goal of providing progressive redistribution to lift the elderly out of poverty.<sup>99</sup>

#### B. Payout of Benefits

The present Social Security system pays benefits in the form of a life annuity;<sup>100</sup> that is, it pays beneficiaries a fixed amount per month based upon a

---

welfare programs to make up for any lost Social Security benefits, they may in fact be well-advised to accept relatively greater investment risks because the government rather than the worker would bear the risk of loss.

98. For a more detailed discussion of Social Security's competing goals of equity and social adequacy, see Moore, *supra* note 12, at 162-64; Moore, *supra* note 15, at 969-70.

99. See *supra* note 15 and accompanying text.

100. See CONGRESSIONAL BUDGET OFFICE, SOCIAL SECURITY PRIVATIZATION AND THE ANNUITIES MARKET 1 (1998) ("An annuity provides a stream of payments for an agreed-upon period of time; a life annuity provides payments for as long as the annuitant is alive and protects against longevity risk.").

complex benefit formula.<sup>101</sup> Because the benefit formula does not take life expectancy into account in calculating benefits (other than making adjustments for individuals who begin to receive before or after their normal retirement age),<sup>102</sup> the system favors individuals with higher life expectancies while disadvantaging those with shorter life expectancies.<sup>103</sup> Thus, the current system's method of paying out benefits tends to favor those at-risk beneficiaries who have higher life expectancies, specifically, women, Hispanics, and Asians, while disfavoring blacks and lower-income workers who have lower life expectancies.<sup>104</sup>

Some partial privatization proposals would also require that benefits be paid out in the form of a life annuity. For example, the Advisory Council's IA plan requires that workers' individual account balances be annuitized upon retirement.<sup>105</sup> Similarly, the Committee for Economic Development favors requiring workers to annuitize their individual account balances upon retirement,<sup>106</sup> and the National Commission on Retirement Policy recommends that individuals be required "to annuitize that portion of their individual savings account balances which, when added to their traditional Social Security benefit, is necessary to provide an income comfortably above the poverty line."<sup>107</sup>

If the proposals were to use a single life table in calculating the annuity, they, like the current system, would disadvantage blacks and lower-income workers while favoring women, Asians, and Hispanics. In theory, the proposals could avoid such differential treatment by using gender-, race-, and socioeconomic-based life tables. In fact, however, using such tables would raise a host of other public policy objections and would thus seem to be ill-advised.

Of course, not all partial privatization proposals require that benefits be paid out in the form of a life annuity. For example, the Advisory Council's PSA plan

---

101. See 42 U.S.C. § 415 (1994). For a discussion of how Social Security benefits are calculated, see Moore, *supra* note 3, app.

102. See 42 U.S.C. §§ 402(q) § (w) (1994); see also 1998 SOCIAL SECURITY EXPLAINED ¶¶ 535.1.

103. See Moore, *supra* note 3, § III(A).

104. See Moore, *supra* note 3, § III(A).

105. I ADVISORY COUNCIL REPORT, *supra* note 21, at 28.

106. FIXING SOCIAL SECURITY, *supra* note 23, at 51. The Archer/Shaw proposal would also require 100% annuitization upon retirement. See *Clinton Charges Republicans With Waffling Over Social Security Reform; GOP Denies It*, 26 PENS. & BEN. REP. (BNA) 1167, 1168 (1999).

107. THE 21ST CENTURY RETIREMENT SECURITY PLAN, *supra* note 24, at 13; see also Jonathan Barry Forman, *Whose Pension Is It Anyway? Protecting Spousal Rights in a Privatized Social Security System*, 76 N.C. L. REV. 1653, 1680-84 (1998) (recommending that at a minimum couples be required to annuitize their account balances to the extent necessary for their total benefits (including first tier benefits) to provide the equivalent of an indexed annuity equal to 125% of the poverty level).

would not require workers to annuitize their account balances upon retirement<sup>108</sup> but instead would permit workers to withdraw assets from their second tier individual accounts as and when they see fit after retirement.<sup>109</sup>

Such proposals would eliminate the differential treatment inherent in the current system's payout of benefits. Thus, at first blush, they would appear to benefit unequivocally those at-risk beneficiaries with lower life expectancies who tend to be disadvantaged by the current system's payout of benefits while disadvantaging those at-risk beneficiaries with higher life expectancies who tend to benefit from the current system. Nevertheless, the proposals could disadvantage members of all three of the at-risk groups by subjecting them to longevity risk, a risk to which they are not subject under the current system and which they are relatively less able to bear.

Finally, regardless of whether partial privatization proposals mandate or permit annuitization of benefits upon retirement, all partial privatization proposals could put members of the at-risk groups at a relative disadvantage by subjecting them to the risk of a market downturn. The current Social Security system does not subject beneficiaries to the risk of a market downturn, and there is reason to believe that women, minorities, and lower-income workers may be less able to handle that risk than higher-income white males.

### 1. Mandatory Annuitization

Since proponents of partial privatization devote far more of their attention to the accumulation phase of partial privatization than to the payout phase,<sup>110</sup> it is hardly surprising that the proposals provide few details on how the annuities are to be calculated. The devil, however, is in the details.<sup>111</sup>

108. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 30 (stating that "workers would not be required to annuitize their accumulations at retirement").

109. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 117 (discussing rationale for not imposing mandatory annuitization requirement).

110. Cf. CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 1 ("Proponents of privatization have devoted most of their efforts to deciding how much should be accumulated in those accounts and how transition costs should be divided among current and future generations, while virtually ignoring how retirees will draw down the accumulated funds for use in old age."); Mark J. Warshawsky, *The Market for Individual Annuities and the Reform of Social Security*, 13 BEN. Q. 66 (1997) ("This focus on the first principles in the public debate has occurred largely in the areas of financing, benefit computation and asset accumulation. Yet the first principle questions concerning the payout phase of any federal retirement income program are just as important.").

111. Cf. JAN WALLISER, *PRIVATIZING SOCIAL SECURITY WHILE LIMITING ADVERSE SELECTION IN ANNUITIES MARKETS* (1997-5 Technical Paper Series, Macroeconomic Analysis and Tax Analysis Divisions, Congressional Budget Office 19, 1997) ("An important and previously ignored question is whether a mandatory annuity would pool males and females.").

If a partially privatized system, like the current system, requires the use of a single life table to calculate annuities, then all workers (of the same age) would receive the same monthly benefits for the same account balances, but all workers would not receive the same expected lifetime benefits. Rather, like the current system, workers with lower life expectancies would, as a group, receive lower lifetime benefits than would workers with higher life expectancies and, conversely, workers with higher life expectancies would, as a group, receive greater lifetime benefits than would workers with lower life expectancies.<sup>112</sup>

Such a system would, like the current system,<sup>113</sup> disfavor at-risk beneficiaries with lower life expectancies,<sup>114</sup> such as blacks<sup>115</sup> and lower-income workers,<sup>116</sup> while favoring at-risk beneficiaries with higher life expectancies, such as women,<sup>117</sup> Hispanics,<sup>118</sup> and Asians.<sup>119</sup> A partially privatized Social

112. See Moore, *supra* note 3, § III(A).

113. See Moore, *supra* note 3, § III(A).

114. Life expectancy at about age 65, rather than age 20, is most relevant for these purposes because that is the approximate age at which workers would be required to annuitize their account balances. Arguably, partial privatization proposals, like the IA plan, that require annuitization upon retirement but permit workers who die before retirement to include their second tier benefit in their estate, see I ADVISORY COUNCIL REPORT, *supra* note 21, at 28 n.17, favor those who are more likely to die before age 65. This advantage would, however, have to be weighed against any reduction the plan may produce in survivor benefits.

115. See, e.g., U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES tbl.129 (1998) (providing that black males at age 65 in 1996 could expect to live another 13.9 years while their white counterparts could expect to live an additional 15.8 years; black females at that age could expect to live another 17.2 years while their white counterparts could expect to live another 19 years). But see U.S. DEP'T OF HEALTH & HUMAN SERVICES, HEALTH, UNITED STATES, 1998: SOCIOECONOMIC STATUS AND HEALTH CHARTBOOK 88-89 & fig. 25 (1998) [hereinafter HEALTH CHARTBOOK] (showing that at age 65 whites and blacks have approximately the same life expectancy once income is taken into account).

116. See, e.g., HEALTH CHARTBOOK, *supra* note 115, at 89 fig.25 (showing that life expectancy rises with family income for both men and women at age 65).

117. See, e.g., HEALTH CHARTBOOK, *supra* note 115, at 89 fig.25 (showing that women at age 65 have higher life expectancy than men at every level of income).

118. Most authorities contend that Hispanics have higher life expectancies than whites at age 65. See, e.g., *Testimony Before the Subcomm. on Social Security, House Comm. on Ways and Means, Social Security and Minorities: Current Benefits and Implications of Reform*, GAO/T-HEHS-99-60 (Statement of Cynthia M. Fagnoni) ("At age 65, in 1998 . . . Hispanic men can expect to live 2.9 years longer than white men . . . The projections of life expectancy for white . . . and Hispanic women at age 65 are 19.5 . . . and 22.2 years, respectively."); SOCIAL SECURITY ADMINISTRATION, WHY IS SOCIAL SECURITY IMPORTANT FOR MINORITY GROUPS? 3 (1999) (showing life expectancy at age 65 in 1995 is 18.5 years for men of Hispanic origin and 15.7 years for their white counterparts and 21.8 years for women of Hispanic origin and 19.1 years for their white counterparts); Kijakazi, *supra* note 17, at 4 ("Hispanic retirees live longer, on average,

Security system that mandated annuitization of benefits upon retirement could avoid this differential treatment by using gender-, race-, and socioeconomic-based life annuity tables.

---

than other Americans—the average American who reaches 65 (including both men and women) will live an additional 17 ½ years, while the average Hispanic reaching 65 lives an additional 20.5 years.”).

Recent work, however, suggests that this differential may be due to underestimated mortality counts and that Hispanics may in fact have lower life expectancies than whites at every age. See Mark D. Hayward & Melonie Heron, *Racial Inequality in Active Life Among Adult Americans*, 36 DEMOGRAPHY 86 tbls.4, 5 (1999) (taking into account mortality adjustments, finding that white women aged 20 in 1990 had life expectancy of 60.93 compared with 57.74 for their Hispanic counterparts and white men aged 20 in 1990 had life expectancy of 54.59 compared with 48.97 for their Hispanic counterparts and finding that white women aged 60 in 1990 had life expectancy of 23.58 compared with 21.46 for their Hispanic counterparts and white men aged 60 in 1990 had life expectancy of 19.10 compared with 17.21 for their Hispanic counterparts); see also Fernando M. Trevino, *Vital and Health Statistics for the US Hispanic Population*, 72 AM. J. OF PUB. HEALTH 979 (1982) (discussing some of the limitations on vital statistics of Hispanics).

119. See SOCIAL SECURITY ADMINISTRATION OFFICE OF POLICY, *supra* note 118, at 3 (showing life expectancy at age 65 in 1995 15.7 for white men, 18.8 for Asian men, 19.1 for white women, and 22.9 for Asian women); CENTERS FOR DISEASE CONTROL AND PREVENTION, 46 MONTHLY VITAL STATISTICS REP. NO. 1(S), at 7 tbl.B (1997) (study of 7 selected states in 1992 shows that life expectancy of Asian/Pacific Islanders between the ages of 65 and 74 was 19.9 years, while life expectancy of their white counterparts was 17.2 years); Hayward & Heron, *supra* note 118, at 86 (taking into account mortality adjustments, finding that white women aged 60 in 1990 had life expectancy of 23.58 compared with 26.36 for their Asian counterparts and white men aged 60 in 1990 had life expectancy of 19.10 compared with 22.22 for their Asian counterparts).

Proponents<sup>120</sup> of "fair"<sup>121</sup> or "efficient"<sup>122</sup> discrimination would likely applaud such a system.<sup>123</sup> Proponents of fair or efficient discrimination believe that the use of any classifier should be permitted so long as the classifier is statistically correlated with risk.<sup>124</sup> That is, insurers should be permitted "to measure as accurately as is practicable the burden shifted to the insurance fund by the policyholder and to charge exactly for it, no more and no less."<sup>125</sup>

Fair or efficient discrimination, however, can run counter to "antidiscrimination"<sup>126</sup> norms grounded in civil rights law concepts.<sup>127</sup>

120. See, e.g., George J. Benston, *The Economics of Gender Discrimination in Employee Fringe Benefits: Manhart Revisited*, 49 U. CHI. L. REV. 489, 512 (1982) (arguing that "all traits associated with a person should be used to estimate the risk that the insured against event will occur to that person"); Maria O'Brien Hylton, *The Allocation of Health Care Resources and Its Effect on the Poor: Some Preliminary Thoughts on the Deregulation of Insurance to Advantage the Working Poor*, 24 FORDHAM URB. L.J. 687, 694-95 (1997) (arguing for reevaluation of ban on racial and other sensitive classifications because reduction in actuarially useful categories of classifications raises cost of doing business and reduces amount of insurance available to certain target groups, such as minorities and high risk consumers); Spencer L. Kimball, *Reverse Sex Discrimination: Manhart*, 1979 AM. B. FOUND. RES. J. 83 (advocating use of gender-based life tables). See also Herman T. Bailey et al., *The Regulatory Challenge to Life Insurance Classification*, 25 DRAKE L. REV. INS. L. ANNUAL 779 (1976) (explaining history of and justifications for classifications in life insurance); Brian A. Jones, *Sex Equality in Pension Schemes*, in TRENDS ON EUROPEAN SOCIAL POLICY: ESSAYS IN MEMORY OF MALCOLM MEAD 85 (Jeff Kenner ed., 1993) (criticizing *Manhart* and *Norris*).

121. See Leah Wortham, *Insurance Classification: Too Important to be Left to the Actuaries*, 19 U. MICH. J.L. REFORM 349 (1986) (describing two principal competing perspectives on insurance classification as "fair" discrimination and "anti-discrimination").

122. See Gaulding, *supra* note 58, at 1647 n.7 (describing the two principal competing views of discrimination in insurance classification as "efficient" discrimination and "antidiscrimination" but recognizing that commentators have adopted a variety of terms to describe these two views).

123. Single-minded advocates of Social Security's individual equity goal should also applaud such a system. Cf. *supra* note 98 and accompanying text.

124. Gaulding, *supra* note 8, at 1665 ("Efficient discrimination requires only that a classifier be statistically correlated with risk.").

125. Kimball, *supra* note 120, at 105.

126. See *supra* notes 121-22.

127. Wortham, *supra* note 121, at 361 ("The antidiscrimination perspective rejects the traditional fair discrimination approach from a perspective grounded in civil rights law concepts. This view opposes the use of certain classifications, particularly those restricted by civil rights laws governing other activities or enterprises."); cf. KENNETH S. ABRAHAM, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY* 76 (1986). Abraham stated:

Some variables with predictive power may be socially, legally, or morally inadmissible for use in constructing risk classes. Race, sex, or age, for



According to these norms, insurers should not be permitted to use classifiers unless they are "(a) causally connected to the risk measured, (b) controllable, and (c) not associated with historical or invidious discrimination."<sup>128</sup>

Today, race-based classifications are uniformly rejected, and antidiscrimination norms govern in this arena. As early as shortly after the Civil War, a couple of states<sup>129</sup> relied on antidiscrimination norms to ban legislatively the use of race-based classifications in life insurance.<sup>130</sup> The norms, however, were not widely adopted until the 1960s,<sup>131</sup> when many states legislatively banned race-based classifications<sup>132</sup> or found that they violated their state's unfair discrimination statutes.<sup>133</sup> In acquiescence to these norms, insurers

---

example, may be good predictors of certain kinds of loss experience. But race is almost always an inadmissible consideration, and both sex and age are sometimes objectionable, depending on the kind of insurance involved.

*Id.*

128. Lea Brilmayer et al., *Sex Discrimination in Employer-Sponsored Insurance Plans: A Legal and Demographic Analysis*, 47 U. CHI. L. REV. 505 (1980) (using antidiscrimination norms to object to gender-based classifications); Gaulding, *supra* note 8, at 1674 (offering positive rights theory that supports prohibition of race- and genetic-based classifications while permitting gender-based discrimination); Robert H. Jerry II & Kyle B. Mansfield, *Justifying Unisex Discrimination: Another Perspective*, 34 AM. U. L. REV. 329 (1985) (contending that classifications on basis of race or sex must be justified by compelling reasons; actuarial justifications not sufficient to support such discrimination); Wortham, *supra* note 121, at 368 (contending that ban of classifications on basis of race, color, religion, sex, and national origin "warranted on grounds that have been advanced by some of those arguing from an antidiscrimination perspective").

129. As a result of the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1994), insurance law is generally regulated by the states rather than the federal government. *See* 15 U.S.C. § 1012(b) (1994) ("No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . .").

130. Wortham, *supra* note 121, at 365 n.68 (citing MASS. GEN. LAWS ANN. ch. 175 § 122 (West 1977) (first passed in 1884); MICH. COMP. LAWS ANN. § 500.2082 (West 1983) (first passed in 1869)).

131. Indeed, insurers "routinely charged blacks and whites different rates for life insurance and annuities" through the 1950s. *See* Jerry & Mansfield, *supra* note 128, at 351 (citing DAN M. MCGILL, LIFE INSURANCE 393-94 (Rev. ed. 1967) (discussing use of racial criteria in insurance rating)).

132. *See* Gaulding, *supra* note 58, at 1659 & n.86 ("Some states passed statutes specifically forbidding the use of race as a classifier.").

133. *See* Gaulding, *supra* note 58, at 1659-60 (stating that "other states assumed this result under their unfair discrimination statutes"); *see also* Herman T. Bailey et al., *supra* note 120, at 793 ("In the civil rights era, some states adopted statutes providing specifically that race (and often creed, national origin and religion) was not to be a criterion for determining whether insurance would be available to a given individual; other states assumed this result under their unfair discrimination statutes.").

converted to race-neutral life tables by the late 1960s,<sup>134</sup> and by the 1980s claimed that they did not use race classifications at all.<sup>135</sup>

Gender-based classifications, on the other hand, are much more controversial.<sup>136</sup> In *Arizona Governing Committee for Tax Deferred Annuity & Compensation Plans v. Norris*,<sup>137</sup> the United States Supreme Court held that Title VII of the Civil Rights Act prohibits the use of gender-based actuarial tables in converting an employer's defined contribution account to an annuity at retirement.<sup>138</sup> In contrast, most states<sup>139</sup> permit insurers to use gender-based annuity tables when issuing individual life annuities,<sup>140</sup> and, at least one state, California, actually requires the use of gender-based tables in calculating premiums for life insurance and annuities.<sup>141</sup>

Unlike race- and gender-based classifications, socioeconomic-based classifications are rarely discussed. Nevertheless, it appears that insurers rarely, if ever, use such classifications to calculate life annuities.<sup>142</sup> Thus, if a partially privatized Social Security system were to use socioeconomic-based life tables, it would appear to be breaking new ground.

At first blush, using race-based life annuity tables might appear to be good public policy. If only two classifications were used, whites and non-whites, non-whites would receive larger monthly benefits than whites because non-whites have lower life expectancies than whites.<sup>143</sup> Thus, the use of race-based life

134. Jerry & Mansfield, *supra* note 128, at 352 n.139 (1985) (noting that "[i]nformation regarding this transformation is sparse").

135. Gaulding, *supra* note 58, at 1660.

136. For a lengthy list of articles entering into this debate, see Wortham, *supra* note 121, at 356 n.31.

137. 463 U.S. 1073 (1983).

138. *Id.* at 1074; *see also* City of Los Angeles Dep't of Water & Power v. Manhart, 435 U.S. 702, 711 (1978) (holding that Title VII prohibits employer from requiring female employees to contribute more to a pension fund than male employees in order to receive same benefit).

139. *But see* Gaulding, *supra* note 58, at 1662 ("Only Montana flatly forbids sex discrimination in insurance.") (citing MONT. CODE ANN. § 49-2-309 (1991)).

140. Gaulding, *supra* note 58, at 1662 ("Most states tolerate the use of sex as a classifier as a form of fair discrimination; where regulators have attempted to ban sex discrimination under unfair discrimination statutes, courts have rebuffed them, stating that actuarially sound discrimination 'cannot be unfair.'").

141. Gaulding, *supra* note 58, at 1662 (citing CAL. INS. CODE § 790.03(f) (West 1993)).

142. Telephone interview with Brian A. Jones, Adjunct Professor, College of Insurance in New York, Consulting Actuary (Apr. 22, 1999) (confirming that very few, if any, insurance companies use socioeconomic-based life tables when issuing annuities); Telephone interview with Herb Pettersen, Actuary (May 26, 1999) (concurring with Mr. Jones's assessment).

143. *See, e.g.*, U.S. DEP'T OF HEALTH & HUMAN SERVICES, CENTERS FOR DISEASE CONTROL AND PREVENTION, NATIONAL CENTER FOR HEALTH STATISTICS, VITAL

annuity tables would seem to benefit rather than harm those "associated with historical or invidious discrimination" and thus be laudable.

Upon more careful reflection, however, the use of race-based life annuity tables would seem to constitute bad public policy. First, our society finds the use of race-based classifications repugnant, whether they benefit or harm the protected group.<sup>144</sup> In fact, the 1979 Social Security Advisory Council rejected a proposal to make unreduced Social Security retirement benefits available at an earlier age to minority groups with lower life expectancies because, among other reasons, it believed that "as a matter of policy, there should be no explicitly different treatment of racial or ethnic groups under Social Security."<sup>145</sup> Second, since there is no universally accepted definition of race,<sup>146</sup> establishing criteria and determining whether a particular individual belongs to a particular group could be socially disruptive and administratively difficult.<sup>147</sup> Moreover, the use of race-based classifications would not necessarily benefit all non-whites. For

STATISTICS OF THE UNITED STATES, 1994, Vol. II, pt. A, sec. 6, tbl.6-3, at 10 (1998) (showing life expectancy of all races, whites, all races other than white, and blacks).

144. See *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200, 227 (1995) (holding that "all racial classifications [whether they benefit or harm the protected group], imposed by whatever federal, state, or local governmental actor, must be analyzed by a reviewing court under strict scrutiny"); cf. *Jerry & Mansfield*, *supra* note 128, at 353 (noting that "[l]ess expensive annuities could be sold to blacks . . . [But that] insurers have been unwilling to use race to calculate insurance rates and premiums because society collectively considers such a practice repugnant").

145. HOUSE COMM. ON WAYS & MEANS, 96TH CONG., REPORT OF THE 1979 ADVISORY COUNCIL ON SOCIAL SECURITY 136 (Comm. Print 1980) [hereinafter 1979 REPORT]. The other reasons it offered were: (1) a belief that the Social Security system as a whole did not treat minorities unfavorably, and thus it would be unfair to the majority to offer significant benefits only to minorities; (2) at least as between blacks and whites, the differential in life expectancy is attributable principally to mortality differences before age 55 and thus it would be inappropriate to offer early retirement benefits to offset this mortality differential; and (3) determining whether a particular individual belongs to a specific racial or ethnic group could create formidable administrative difficulties and establishing the criteria could be socially disruptive. See 1979 REPORT, *supra*, at 136-37.

146. See, e.g., Michael Omi & Harold Winant, *Racial Formations, in POWER, PRIVILEGE AND LAW: A CIVIL RIGHTS READER* 159, 160 (1995) ("Race is indeed a pre-eminent sociohistorical concept. Racial categories and the meaning of race are given concrete expression by the specific social relations and historical context in which they are embedded. Racial meanings have varied tremendously over time and between different societies."); Luther Wright, Jr., Note, *Who's Black, Who's White, and Who Cares: Reconceptualizing the United States's Definition of Race and Racial Classifications*, 48 VAND. L. REV. 513, 517 (1995) ("The word 'race' defies precise definition in American Law.' No physical attribute or collection of physical attributes adequately defines 'race.'") (citation omitted).

147. See 1979 REPORT, *supra* note 145, at 137.

example, although blacks have lower life expectancies than whites,<sup>148</sup> other groups,<sup>149</sup> such as Hispanics,<sup>150</sup> have higher life expectancies than whites.<sup>151</sup> A system that classified Hispanics separately from whites could result in Hispanics receiving smaller monthly benefits than whites for the same account balances, although members of the two groups would receive equal expected lifetime benefits. Finally, using race-based classifications to benefit a protected group could open the door to the use of such classifications to harm protected groups, contrary to the very purpose of civil rights statutes.

Permitting or requiring the use of gender-based life annuity would also appear to be bad public policy. Given women's somewhat greater reliance on Social Security for their retirement income<sup>152</sup> and their greater risk of poverty in old age,<sup>153</sup> it would appear to run counter to Social Security's social adequacy goal<sup>154</sup> to permit or require insurers to pay women lower monthly benefits<sup>155</sup> than men for the same account balances simply because women have higher life expectancies than men.<sup>156</sup> Moreover, it would seem inappropriate<sup>157</sup> for the

148. *See supra* note 115.

149. Given the indeterminacy of the term 'race,' it is not clear which groups should be treated as a separate race. Hispanics are sometimes treated as a separate race, sometimes not. *See Wright, supra* note 147, at 537-38, 548-50 (discussing inconsistency in classification of Hispanics).

150. As discussed note 118 *supra*, there is some question as to whether this higher life expectancy is due to underestimated mortality counts and that Hispanics in fact have lower life expectancies than whites.

151. Asians also have higher life expectancies than whites at age 65. *See supra* note 119.

152. *See supra* note 93.

153. *See infra* Part III(E)(1).

154. Of course, using gender-based tables may be consistent with Social Security's goal of individual equity. *Cf. supra* notes 98-99 and accompanying text.

155. *See WOMEN'S RETIREMENT INCOME, supra* note 64, at 11-12 & tbl.1 (showing average monthly benefit paid to men and women at different ages, based on \$100,000 premium in current individual annuity market which permits use of gender-based life tables).

156. For married workers purchasing joint and survivor annuities, annuity payments would depend on the age of each of the spouses in the couple rather than the gender of the worker purchasing the annuity. Thus, much of the disparate impact created by the use of gender-based annuity tables would be eliminated in the case of married workers purchasing joint and survivor annuities rather than single-life annuities. *Cf. I ADVISORY COUNCIL REPORT, supra* note 21, at 28 (explaining that Advisory Council's IA plan permits a married worker (with the consent of the spouse) to choose between a single or 'joint and survivor' annuity).

157. Although the Congressional Accountability Act of 1995 made Title VII of the Civil Rights Act applicable to the legislative branch of the Federal Government, *see P.L. 104-1, § 102(a)(2), 109 Stat. 3, 5 (1995)*, determining whether Title VII of the Civil Rights Act does or should apply to a federally mandated partially privatized Social Security system goes beyond the scope of this Article.

federal government to require employer-based retirement plans to use unisex life tables while permitting or requiring insurers to use gender-based tables under a federally mandated partially privatized Social Security system.<sup>158</sup>

The use of socioeconomic-based life tables does not raise the same public policy concerns as the use of race- or gender-based classifications. Our society does not view economic-based differentiation with the same suspicion as race- and gender-based distinctions.<sup>159</sup> Moreover, socioeconomic-based classifications would likely ensure that all lower-income workers receive higher monthly benefits than higher-income workers for the same account balances because

158. Such a provision may well violate the Due Process Clause of the Fifth Amendment. Analyzing whether the use or prohibition of gender-based annuity tables would violate the Due Process Clause of the Fifth Amendment, however, goes beyond the scope of this Article. For cases in which the United States Supreme Court has considered Due Process challenges to Social Security provisions that imposed gender-based distinctions, see *Heckler v. Matthews*, 465 U.S. 728 (1984) (upholding rule requiring only male spouses in certain circumstances to show dependency); *Califano v. Webster*, 430 U.S. 313 (1977) (upholding definition of "elapsed years" for benefit computation purposes that includes three fewer years for women than for men); *Califano v. Goldfarb*, 430 U.S. 199 (1977) (holding unconstitutional imposition of financial dependence test on widower's benefits but not on widow's benefits); *Weinberger v. Wiesenfeld*, 420 U.S. 36 (1975) (holding unconstitutional provision of survivor benefits to widows, but not widowers). For a discussion of these cases, see Mary E. Becker, Comment, *Obscuring the Struggle: Sex Discrimination, Social Security, and Stone, Seidman, Sustein & Tushnet's Constitutional Law*, 89 COLUM. L. REV. 264, 271-76 (1989). Cf. Kimball, *supra* note 120, at 105-06 n.54 (noting that federal statute that prohibited use of gender-based life table would leave "possible constitutional issue: Whether such a rule is, *inter alia*, an unconstitutional denial of equal protection to men in annuities and women in life insurance").

159. For example, for purposes of the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution, racial classifications are viewed as "suspect" and thus subject to strict scrutiny review. See RONALD D. ROTUNDA & JOHN E. NOVACK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 18.5, at 294 (3d ed. 1999). Gender-based classifications are viewed as semi-suspect and subject to an intermediate level of scrutiny. *Id.* § 18.20, at 518. Classifications based on wealth are not viewed as suspect and thus are generally subject to rational basis review. *Id.* § 18.25, at 560. See, e.g., *San Antonio Independent Sch. Dist. v. Rodriguez*, 411 U.S. 1, 28, 44 (1973) (finding that wealth is not a suspect class and thus classifications based on wealth subject to traditional rational basis review). Similarly, civil rights statutes generally prohibit discrimination on the basis of race and gender but do not extend their protection to class-based discrimination. See, e.g., 42 U.S.C. § 2000e-2 (1994) (prohibiting employment discrimination on the basis of race, color, religion, sex, or national origin); 42 U.S.C. § 3604 (1994) (prohibiting discrimination in housing on basis of race, color, religion, sex, familial status, or national origin); KY. REV. STAT. ANN. § 344.040 (Michie 1997) (prohibiting employment discrimination on basis of race, color, religion, national origin, sex, or age forty and over, or status as smoker).

lower-income workers, no matter their race or sex, almost always have lower life expectancies than their higher-income counterparts.<sup>160</sup>

Nevertheless, it still may not be wise to require the use of socioeconomic-based tables. First, since insurers do not currently use socioeconomic-based life tables to calculate life annuities, the creation of such tables may be too costly and thus inefficient.<sup>161</sup> Moreover, if neither race- nor gender-based tables are used, it would seem inappropriate to establish socioeconomic distinctions.

## 2. Voluntary Annuitization of Lump Sum Accumulations

By not requiring that second tier benefits be annuitized upon retirement, partial privatization proposals, like the Advisory Council's PSA plan, eliminate the differential treatment inherent in the current system's payout of benefits.<sup>162</sup> Thus, such proposals would appear to benefit unequivocally those at-risk beneficiaries with lower life expectancies, such as blacks and lower-income workers, who tend to be disadvantaged by the current system's payout of benefits, while disadvantaging those at-risk beneficiaries with higher life expectancies, like women, Hispanics, and Asians, who tend to be favored by the current system's payout of benefits.<sup>163</sup> In fact, however, members of all three of the at-risk groups could still be disadvantaged by a partial privatization proposal, like the Advisory Council's PSA plan, that does not mandate the annuitization of the second tier account balance upon retirement.

By promising beneficiaries a specified amount per month for life, the current Social Security system protects workers against longevity risk; that is, the risk of outliving their assets.<sup>164</sup> Similarly, partial privatization proposals, like

---

160. See *supra* note 116. But see C. J. L. MURRAY ET AL., U.S. PATTERNS OF MORTALITY BY COUNTY AND RACE: 1965-1994, U.S. BURDEN OF DISEASE AND INJURY MONOGRAPH SERIES 8, 10 (1998) (noting that (1) one of the poorest regions in the country, the Texas border with Mexico, is a region with above average life expectancy, and (2) life expectancy for black males does not always rise with income).

161. Cf. ABRAHAM, *supra* note 127, at 78. Abraham stated:

[A]n efficient classification system does not strive to make its premiums equal expected cost beyond the point where that goal is worth achieving. Information about risks is accumulated and risk classes are refined only so long as competitive benefits of refinement are worth their cost. Consequently, all individual differences are not recognized by a classification system. When an insurer can no longer attract or make enough profit from additional low-risk insureds to justify discovering and classifying them, an equilibrium is reached, and no further refinement occurs.

ABRAHAM, *supra* note 127, at 78.

162. See Moore, *supra* note 3.

163. See *supra* notes 112-29 and accompanying text.

164. See CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 1 ("Annuities like Social Security provide insurance against longevity risk—that is, the risk of outliving personal resources").

the Advisory Council's IA plan, that require workers to annuitize their individual account balances upon retirement, also protect workers from the risk of outliving their individual account balances. In contrast, partial privatization proposals, like the Advisory Council's PSA plan, that impose no restrictions on the withdrawal of second tier assets after retirement subject workers to the risk of outliving their individual account balances.<sup>165</sup>

Although proposals like the Advisory Council's PSA plan would subject all workers to the risk of outliving their second tier benefit, not all workers are equally able to bear that risk. The more a Social Security beneficiary relies on Social Security for her retirement income, the less she is able to bear the risk of outliving any of that income.<sup>166</sup> As discussed above,<sup>167</sup> women and minorities tend to rely somewhat more heavily on Social Security for their retirement income than do men and nonminorities, and older individuals with lower incomes rely on Social Security for a significantly larger percentage of their income than do those with higher incomes. Thus, the proposals like the Advisory Council's PSA plan that subject workers to the risk of outliving their second tier benefit would appear to disproportionately disadvantage women and minorities to some extent and lower-income workers to a greater extent.<sup>168</sup>

Arguably, members of the at-risk groups could protect against this longevity risk by voluntarily purchasing individual life annuities from the private market with their account balances upon retirement.<sup>169</sup> These individuals, however,

165. Of course, to the extent that they guarantee a first tier benefit, they do not subject workers to the risk of outliving all Social Security benefits.

166. Again, as noted above, under a partially privatized system, workers would still be guaranteed some benefits for life from their first tier benefit.

167. See *supra* notes 93-95 and accompanying text.

168. In addition, as the proponents of the Advisory Council's PSA plan note, there is a moral hazard that these groups might intentionally exhaust their individual account balances prematurely if other federal safety net programs are available to these retirees and the programs tie eligibility to low assets. To protect against this moral hazard, the proponents of the PSA plan contend that it might be appropriate to require annuitization of the account balances of retirees who cannot show that they have annuity incomes from Social Security and private savings that equal the poverty level or some multiple thereof over their life expectancy, although they ultimately reject this requirement. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 117; see also Warshawsky, *supra* note 112, at 70 (contending that any partial privatization proposal "should require annuitization to avoid moral hazard problems upon the introduction of the new system").

169. Indeed, a Congressional Budget Office paper asserts that the demand for annuities would probably increase, especially for low- and median-income households if Social Security benefits were reduced. See CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 21.

might be forced to accept less than actuarially fair rates of returns<sup>170</sup> if they were to annuitize their individual account benefit upon retirement.<sup>171</sup>

Economists have found that yields on individual life annuities are lower than yields on alternative long-term fixed-income investments.<sup>172</sup> Thus, experience in the current individual life annuity market suggests that at-risk retirees who elect to annuitize their account balances upon retirement could be subjected to lower rates of return on their account balances than retirees who can afford the risk of outliving their account balances and thus can invest their account balances outside of the individual annuity market.<sup>173</sup>

Of course, past market experience may not be a good predictor of experience under a partially privatized Social Security system. Although the

170. The rate of return on an annuity is actuarially fair if it is equal to the rate of return on riskless bonds. See Andrew B. Abel, *Capital Accumulation and Uncertain Lifetimes with Adverse Selection*, 54 *ECONOMETRICA* 1079, 1082 (1986).

171. Cf. CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 2 ("Private annuities are currently 15 percent to 25 percent more expensive than average mortality would suggest.").

172. For example, Friedman and Warshawsky have found that the expected yields offered on individual life annuities in the United States during 1968 through 1983 were lower on average by 4.21-6.13% per annum, or 2.43-4.35% per annum after allowing for adverse selection, than yields on alternative long-term fixed-income investments. Benjamin M. Friedman & Mark J. Warshawsky, *The Cost of Annuities: Implications for Saving Behavior and Bequests*, 105 Q. J. ECON. 135, 152 (1990) [hereinafter *Cost of Annuities*]. Similarly, Mitchell, Poterba, and Warshawsky found that the average individual life annuity policy delivered payouts valued at between 80 and 85 cents per dollar of annuity premium in 1995. OLIVIA S. MITCHELL ET AL., *NEW EVIDENCE ON THE MONEY'S WORTH OF INDIVIDUAL ANNUITIES* (National Bureau of Econ. Research Working Paper No. 6002, 1997); see also Benjamin M. Friedman & Mark Warshawsky, *Annuity Prices and Saving Behavior in the United States*, in *PENSIONS IN THE U.S. ECONOMY* 53, 59 (Zvi Bodie et al. eds., 1988) [hereinafter *Annuity Prices*] (contending that individual life annuities have an average load factor of 32-48 cents per dollar, 14-15 cents of which is attributable to adverse selection while 18-33 cents represents the insurer's costs, taxes, and profits).

173. To the extent that these lower returns are due to adverse selection, see *infra* note 179, they would not occur under a partially privatized system that mandated annuitization of benefits upon retirement because such a system would necessarily eliminate adverse selection. To the extent, however, that they are due to other factors, they may or may not occur under a partially privatized system that mandates annuitization of benefits upon retirement.

In correspondence with the Author, Brian A. Jones has suggested that life insurers offer a "Round-Out" annuity contract that would pay installments for life only after the end of a fixed payout period. The "Round-Out" annuity would be a deferred annuity that would be paid at the end of the payout period only if a worker outlived his life expectancy. Jones believes that this product would be a useful supplement to IRAs and other current retirement benefits as well as useful under a partially privatized system that permits but does not require annuitization of second tier benefits.



individual annuity market is well-developed in this country,<sup>174</sup> few of the elderly currently participate in that market.<sup>175</sup> Moreover, those who do participate in the market<sup>176</sup> tend to have higher life expectancies,<sup>177</sup> and their higher life expectancies<sup>178</sup> explain, at least in part, the lower yields on individual life annuities.<sup>179</sup> If participation in the individual annuity market were to increase

174. See, e.g., *Annuity Prices*, *supra* note 172, at 53 (noting that “a well-developed individual life annuity market does exist in the United States”).

175. *Cost of Annuities*, *supra* note 172, at 136 n.2 (noting that the Retirement History Survey indicates that only 2% of the elderly population own individual annuities of any sort); see also CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 5-8 (offering reasons for small size of single-premium immediate annuities market).

176. There are a wide variety of annuities available on the market today. For a general discussion of the annuities market, see, e.g., JAMES M. POTERBA, *THE HISTORY OF ANNUITIES IN THE UNITED STATES* (National Bureau of Econ. Research Working Paper No. 6001, 1997). This section, however, focuses on single-premium immediate annuities (SPIA) because they are typically paid out in the form of a life annuity, while other annuities may often be paid out in other forms. See MITCHELL ET AL., *supra* note 172, at 5. The Congressional budget office report noted:

According to data of the Life Insurance Marketing Research Association International (LIMRA), most people who purchased a SPIA from any of 26 companies included in a survey chose an annuity for life (single-premium immediate life annuities, or SPILAs). SPILAs closely parallel current Social Security annuity payments in all respects but one: they are not indexed for inflation. Therefore, prices for SPILAs most accurately reflect the cost of insurance against longevity risk at retirement . . . .

CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 4.

177. MITCHELL ET AL., *supra* note 172, at 14 (“When compared within the same year and cohort, the mortality probabilities for both men and women in the general population at every age are higher than the mortality probabilities for annuity purchasers.”).

178. Mitchell, Poterba, and Warshawsky note that the mortality difference may be due to two nonexclusive factors: (1) individuals with higher than average net worth may live longer than those without substantial assets, and (2) individuals who purchase individual annuities may live longer, on average, than those who do not purchase such annuities. MITCHELL ET AL., *supra* note 172, at 14. The second factor is frequently referred to as adverse selection. See Warshawsky, *supra* note 110, at 70 (noting that adverse selection “occurs if individuals with higher-than-average mortality risk, such as those with serious illness or with inherited or behavioral predispositions toward certain diseases, conclude that annuities are too expensive for them and thereby avoid the purchase of annuities”).

179. See, e.g., MITCHELL ET AL., *supra* note 172, at 21 (“Adverse selection appears to explain roughly half of the disparity between the expected discounted present value of annuity payouts, and the cost of an individual annuity, from the standpoint of an average individual.”); *Annuity Prices*, *supra* note 172, at 59 (contending that between one-third and one-half of load factor of individual life annuities is attributable to adverse selection, while the remainder represents the insurer’s costs, taxes, and profits); *Cost of Annuities*, *supra* note 172, at 152 (contending that about half of lower yield on individual

substantially, and more individuals with average or lower-than-average life expectancies were to enter the market, yields on individual life annuities would likely increase.<sup>180</sup>

Increased yields would benefit minorities and lower-income workers who chose to annuitize their second tier account balances upon retirement. Women, however, would be less likely to benefit from increased yields. Most life insurers currently use gender-based annuity tables when issuing individual life annuities and pay women lower monthly payments than men for the same premium.<sup>181</sup> Unless a partially privatized system were to require insurers to use unisex life tables, as they currently must for annuities for employer-provided retirement plans,<sup>182</sup> women who voluntarily chose to annuitize their account balance on retirement would likely receive lower monthly payments than men for the same premium, although their lifetime benefits would be actuarially equivalent.

### 3. Risk of Market Downturn

Regardless of whether they mandate or permit annuitization of benefits upon retirement, all partial privatization proposals subject workers to the risk of a market downturn, a risk that is not present in the current Social Security system. That risk could have a disproportionately adverse effect on all three of the at-risk groups.

While the average real return on stocks in the United States has been about seven percent over the last one hundred years,<sup>183</sup> returns over shorter periods of time have fluctuated enormously.<sup>184</sup> These market fluctuations could have a dramatic impact on returns particular workers can earn, depending on the year

---

life annuities attributable to adverse selection); *see also* CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 10-13 (discussing the effect of adverse selection on pricing in the annuities market).

180. *Cf.* CONGRESSIONAL BUDGET OFFICE, *supra* note 100, at 21-22 (discussing study that shows that cost of adverse selection could fall by one to two percentage points if Social Security benefits were entirely replaced by individual accounts); MITCHELL ET AL., *supra* note 172, at 29 (noting that mandating a national annuity pool could alter the set of individuals who purchase annuities and thus alter the pricing of the products).

181. *See* WOMEN'S RETIREMENT INCOME, *supra* note 64, at 11-12 & tbl.1 (showing average monthly benefit paid to men and women at different ages, based on \$100,000 premium).

182. *See supra* notes 137-38 and accompanying text.

183. *See supra* note 37 and accompanying text.

184. *See* Moore, *supra* note 12, at 154-55; *see also* John D. Reas & Richard G. Marcis, *Responses of Mutual Fund Investors to Adverse Market Disruptions*, in LIVING WITH DEFINED CONTRIBUTION PENSIONS: REMAKING RESPONSIBILITY FOR RETIREMENT 136, 141 (Olivia S. Mitchell & Sylvester J. Schieber eds., 1998) (describing market cycles between World War II and 1994).

in which they retire.<sup>185</sup> For example, an individual account earning the inflation-adjusted S&P 500 rate from 1967 to 1986 would have earned 3.7% over that 21-year period. In contrast, an individual account earning the inflation-adjusted S&P rate from 1965 to 1984 would have earned just 1.4% over that 19-year period.<sup>186</sup> Similarly, an individual account earning interest at the inflation-adjusted interest rate for corporate bonds from 1970 to 1980 would have earned 3.2% over that 10-year period while an individual account earning interest at the inflation-adjusted interest rate for corporate bonds from 1965 to 1984 would have earned -1% over that 9-year period.<sup>187</sup>

In a partially privatized system that mandated annuitization of benefits upon retirement, these market fluctuations might be viewed as affecting all individuals who retire at the same time equally (though they could create inequities in the treatment of individuals who retire in different years, or even months, depending on how the annuities are calculated).<sup>188</sup> On the other hand, to the extent that at-risk beneficiaries rely disproportionately on Social Security benefits for their retirement income,<sup>189</sup> market fluctuations may be said to have a disproportionately adverse impact on these groups because they are less able than other beneficiaries to bear the risk of a market downturn.<sup>190</sup>

Arguably, under a partial privatization proposal that permits but does not require annuitization of individual account balances upon retirement, all workers

185. Moore, *supra* note 12, at 154-55.

186. PROPOSAL TO PRIVATIZE, *supra* note 33, at 8.

187. PROPOSAL TO PRIVATIZE, *supra* note 33, at 8.

188. Jeffrey N. Gordon has proposed a financial product, a "pension equity collar," that could resolve this timing problem. This product, which would be offered through investment banks, would guarantee investors a floor value for stock in exchange for which investors would give up the gain above a certain level. See Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1563-64 (1997); see also Peter A. Diamond, *The Economics of Social Security Reform*, in FRAMING THE SOCIAL SECURITY DEBATE: VALUES, POLITICS, AND ECONOMICS 38 (R. Douglas Arnold et al. eds., 1998). Diamond stated that:

This risk can be somewhat attenuated by annuitizing part of the fund in successive years near retirement age or by allowing the worker some choice as to the date of annuitization. Also the risk can be hedged by moving the accumulation portfolio to one predominantly of long-term bonds, which matches the portfolio used by insurance companies when pricing annuities.

*Id.*

189. See *supra* notes 93-94 (explaining that women and minorities tend to rely somewhat more heavily on Social Security for retirement benefits).

190. To the extent that other beneficiaries rely on private defined contribution plans for additional retirement income, they may be no better able to handle market fluctuations with respect to their social security benefits than are at-risk beneficiaries. Beneficiaries who rely on defined benefit plans or other assets not tied to market fluctuations for additional retirement income, however, may be better able to bear market fluctuations with respect to their social security benefits.

could avoid the adverse effects of a market downturn by not touching their individual account balances during market downturns. At-risk beneficiaries, however, may be less able than other beneficiaries to ride out market downturns. To the extent that at-risk beneficiaries disproportionately rely on Social Security benefits for their retirement income, they may be less able than others to limit their social security income to their first tier benefit.<sup>191</sup> Thus, partial privatization proposals that permit but do not require annuitization upon retirement could also adversely impact at-risk beneficiaries due to the risk of market downturns.

#### 4. Conclusion

Mandatory annuitization of a partially privatized Social Security system raises a significant issue regarding how those annuities are to be calculated. If a single life table were used, then mandatory annuitization, like the current system, would disfavor those at-risk groups with lower life expectancies, such as blacks and lower-income workers, and favor those at-risk groups with higher life expectancies, such as women, Asians, and Hispanics. Partial privatization proposals could eliminate this differential treatment by using race-, gender-, and socioeconomic-based life annuity tables, but would contravene other important public policies in doing so.

Partial privatization proposals that impose no restrictions on the withdrawal of assets from the second tier after retirement could eliminate the differential treatment inherent in the current system's payout of benefits and thus, relative to the current system, favor blacks and lower-income workers and disfavor women, Hispanics, and Asians. An analysis of such proposals' effect on at-risk beneficiaries, however, does not end there.

Unlike the current system, partial privatization proposals that do not mandate annuitization of second tier benefits upon retirement subject workers to the risk of outliving their second tier benefit. To the extent that at-risk beneficiaries rely disproportionately on Social Security for their retirement income, they may be less able to bear that risk than are higher-income white men. At-risk beneficiaries could avoid the risk of outliving their individual account balances by voluntarily annuitizing their second tier benefit upon retirement. If they were to voluntarily annuitize their benefits, however, current individual annuity market trends suggest that they could be forced to accept lower rates of return than retirees who can afford the risk of outliving their individual account balances. If enough at-risk beneficiaries were to annuitize their second tier benefits voluntarily, rates of return might improve relative to the

---

191. The ability of other beneficiaries to ride out market downturns would depend on the source of their other retirement income. To the extent that other beneficiaries relied on private defined contribution plans for additional retirement income, they would be no more able to limit their social security income to first tier benefits than would at-risk beneficiaries.

current market. Nevertheless, women would not necessarily benefit from improved rates of return. If insurers continued to use gender-based life tables under a partially privatized system, women who voluntarily annuitized their individual account balances would receive lower monthly benefits than would similarly situated men, although their total lifetime benefits would be actuarially equivalent.

Finally, all partial privatization proposals subject workers to the risk of a market downturn, a risk that is not present in the current Social Security system. Because members of the at-risk groups may rely disproportionately on Social Security for their retirement income, they may be less able than other beneficiaries to bear the risk of a market downturn they must face under a system that mandates partial privatization, and they may be less able to ride out and thus avoid the adverse effect of a market downturn under a system that permits but does not require annuitization upon retirement.

### C. *Progressive Benefit Formula*

The current Social Security system uses a progressive benefit formula to calculate benefits that is specifically designed to redistribute income from higher-paid workers to lower-paid workers.<sup>192</sup> Since women and minorities (other than Asians) tend to be lower-paid,<sup>193</sup> the current system's progressive benefit formula tends to benefit all three of the at-risk groups (with the exception of Asians).<sup>194</sup>

Partial privatization could jeopardize political support for the progressivity inherent in the current Social Security system's progressive benefit formula. This potential reduction or even elimination of progressivity could have a disproportionately adverse effect on the benefits of all three of the at-risk groups (with the exception of Asians) because they tend to benefit from the current system's progressive benefit formula.

A partially privatized system cannot, by definition, use a progressive benefit formula to calculate the second tier benefit. The second tier benefit is provided through a defined contribution account which bases benefits on contributions and

---

192. Specifically, for those reaching age 62 in 1999, the formula replaces 90% of the first \$505 of average indexed monthly earnings, plus 32% of average indexed monthly earnings between \$505 and \$3,043, plus 15% of average indexed monthly earnings above \$3,043. See BOARD OF TRUSTEES OF SOCIAL SECURITY TRUST FUNDS, 106TH CONG. REPORT ON FEDERAL OLD-AGE & SURVIVOR INSURANCE & DISABILITY INSURANCE (1999). For a more detailed discussion of how Social Security benefits are calculated, see Moore *supra* note 3, app.

193. See *supra* notes 18, 60-61 and accompanying text.

194. For a full discussion of how the current system's progressive benefit formula redistributes income within the current Social Security system, see Moore, *supra* note 3, § III(B).

earnings or losses on those contributions, and not on a defined benefit formula.<sup>195</sup> Nevertheless, a partially privatized system could still retain the progressivity of the current benefit formula in one of two ways: (1) by providing for matching contributions to private accounts on a progressive basis,<sup>196</sup> or (2) by adjusting the first tier formula to recover the subsidy higher-wage workers currently provide lower-wage workers through the progressive benefit formula.<sup>197</sup>

Although a partially privatized system could, in theory, provide for progressive contributions to the second tier,<sup>198</sup> partial privatization proposals rarely provide for such contributions.<sup>199</sup> Instead, most proposals limit progressivity to the first tier benefit.<sup>200</sup>

Some of the partial privatization proposals provide for a flat first tier benefit. The Social Security Advisory Council's PSA plan, for example,

195. See *supra* notes 27-32 and accompanying text.

196. Of course, progressive contributions could not guarantee progressive benefits because benefits from a defined contribution plan are always subject to investment risk. Progressive contributions, however, would at least provide some level of progressivity in the second tier benefit.

197. See, e.g., PROPOSAL TO PRIVATIZE, *supra* note 33, at 6-7 (describing benefit adjustment devised that recovers subsidy high earners would have provided to low earners).

198. Cf. Laurence J. Kotlikoff et al., *Social Security and the Real Economy: Evidence and Policy Implications*, *Social Security: Privatization and Progressivity*, 88 AM. ECON. REV. 137 (1998) (developing model that gradually fully privatizes Social Security while retaining its redistributive effects by providing for matching contributions to individual accounts on a progressive basis and financing transition costs with a consumption tax).

199. For a rare proposal providing for progressive contributions to individual accounts, see Elizabeth A. White, *Social Security: Sperling Calls for Preserving Surplus in Response to Proposed Private Accounts*, 25 PENS. & BEN. REP. (BNA) 1725, 1725 (1998) [hereinafter *Sperling*] (discussing Roth bill that would provide for flat \$250 plus additional amount based on worker's share of payroll taxes to be deposited in each individual account). See also 'Progressive' Formula for Private Accounts Included in Proposal Santorum to Offer, 26 PENS. & BEN. REP. (BNA) 575 (1999) (describing Social Security reform bill that Senator Santorum plans to introduce that would create formula under which lower-income workers would divert higher percentage of their payroll taxes into individual accounts); Elizabeth A. White, *Social Security: Bipartisan Senate Group Unveils Reform Bill Including Private Accounts*, 26 PENS. & BEN. REP. (BNA) 1407 (1999) (discussing bipartisan bill to be introduced that will provide for government match of voluntary contributions of low-income workers).

200. The absence of proposals that provide for progressivity in the second tier may be attributable to the fact that advocates of privatization or partial privatization generally support severing Social Security's provision of individual equity from that of social adequacy. Cf. DIFFERENT APPROACHES, *supra* note 33, at 26-27 (discussing annuity-welfare model of Social Security); Moore, *supra* note 12, at 162-68 (discussing current system's balancing of individual equity and social adequacy and how privatization relates to that balance).

provides for a flat first tier benefit for all workers under age 25 in 1998 equal to \$410 per month in 1996, or the equivalent of 65% of the current poverty level for an elderly persons living alone or 76% of the benefit payable to a low wage worker retiring in 1996.<sup>201</sup> Because first tier benefits are funded with a 7.4% payroll tax<sup>202</sup> which requires that higher-wage workers make larger absolute contributions to the system than lower-wage workers,<sup>203</sup> the flat first tier benefit provides lower-wage workers with a higher return on their contributions than it does higher-wage workers and thus is progressive.<sup>204</sup>

Other proposals base first tier benefits in part on earnings but use a progressive benefit formula to calculate those benefits. The Social Security Advisory Council's IA plan, for example, uses a progressive benefit formula to calculate benefits. Specifically, the IA plan retains the current system's 90% replacement rate for low earnings and decreases the current system replacement rate for middle and high earnings from 32% to 22.4% and 15% to 10.5%, respectively.<sup>205</sup> The National Commission on Retirement Policy proposes both a minimum benefit, for which individuals would be eligible after twenty years of covered earning, and a first tier benefit based in part on earnings.<sup>206</sup> Like the IA plan, the National Commission's proposal would gradually decrease the replacement rates for middle and high earnings.<sup>207</sup>

Although proponents of partial privatization typically express support for the current system's progressivity,<sup>208</sup> partial privatization could put Social Security's progressivity at risk. If partial privatization were as successful as proponents predict, middle- and higher-income workers should receive substantially higher rates of return from their second tier individual account benefits than from their first tier benefits,<sup>209</sup> and these higher rates of return could

201. I ADVISORY COUNCIL REPORT, *supra* note 21, at 31.

202. I ADVISORY COUNCIL REPORT, *supra* note 21, at 30.

203. Of course, the progressivity ceases once the maximum taxable wage base is reached. See 26 U.S.C. § 3121(a)(1) (Supp. III 1997). For a more detailed discussion of the taxable wage base, see Moore, *supra* note 3, app.

204. Cf. *Sperling*, *supra* note 199 (describing how flat contributions under Roth bill are progressive).

205. I ADVISORY COUNCIL REPORT, *supra* note 21, at 29. The Committee for Economic Development makes a similar proposal. See *FIXING SOCIAL SECURITY*, *supra* note 23, at 38-39.

206. See S. 2313, 105th Cong. (1998); H.R. 4256, 105th Cong. (1998) (introducing proposals from the National Commission on Retirement Policy).

207. S. 2313, 105th Cong. (1998); H.R. 4256, 105th Cong. (1998).

208. See Moore, *supra* note 15, at 981-82 (giving examples of proponents' expression of support).

209. These higher rates of return would be due to two factors: (1) the first tier benefit would remain funded on a pay-as-you-go basis while the second tier benefit would be funded in advance, and (2) the first tier benefit would provide for redistribution while the second would not. See Moore, *supra* note 15, at 983.

erode political support for the first tier benefit.<sup>210</sup> Specifically, middle- and higher-income workers could point to the substantially higher rates of return available from the second tier and demand that the first tier be eliminated and all of their contributions be used to fund their second tier benefit.<sup>211</sup>

Of course, partial privatization need not erode political support for the first tier benefit.<sup>212</sup> Partial privatization might not be as successful as proponents predict.<sup>213</sup> Moreover, even if partial privatization were as successful as proponents predict, it could increase rather than decrease political support for the first tier. Having received higher rates of return on their second tier benefit, middle- and higher-income workers could feel more altruistic and thus more supportive of the first tier benefit.<sup>214</sup> Such altruism, however, is inconsistent with the current demand for higher rates of return underlying the push for partial privatization<sup>215</sup> as well as trends in charitable giving.<sup>216</sup> Absent altruism, middle- and higher-income workers might still retain support for Social Security's first tier benefit because it offers benefits not provided by the second tier, such as disability and dependents' benefits.<sup>217</sup> Currently, though, most workers tend to ignore those benefits, which suggests that middle- and higher-income workers would not support the first tier benefit for this reason.<sup>218</sup>

In sum, partial privatization need not upset the progressivity of the current system. In fact, however, if partial privatization were as successful as proponents predict, its very success could jeopardize political support for Social Security's progressive benefit formula. Since all three of the at-risk groups (with the exception of Asians) benefit from the current system's progressive benefit formula, partial privatization could have a disproportionately adverse affect on the benefits of all three of the at-risk populations (other than Asians) by jeopardizing the progressivity of the system.<sup>219</sup>

210. See Moore, *supra* note 15, at 984-85.

211. See Moore, *supra* note 15, at 984.

212. See Schieber, *supra* note 3, at 177 ("If we can convince the American people that it is desirable to create retirement income redistribution through a single-tiered system by means of a tilted benefit formula, it is inconceivable that we cannot convince them that similar redistribution is desirable through a two-tiered system.").

213. See Moore, *supra* note 15, at 985 n.72.

214. See Moore, *supra* note 15, at 986-87.

215. See *supra* notes 33-39 and accompanying text.

216. See Moore, *supra* note 15, at 986-87 (noting that charitable giving does not steadily rise with income but rather remains relatively constant until income exceeds \$100,000, and even then remains relatively limited).

217. See Moore, *supra* note 15, at 987.

218. See Moore, *supra* note 15, at 987.

219. For arguments on the importance of retaining progressivity within the Social Security system, see DIFFERENT APPROACHES, *supra* note 32, at 28; Moore, *supra* note 12, at 164-68; Moore, *supra* note 15, at 988-92.



*D. Disability Benefits*

Not only does the current Social Security system pay benefits to retired workers, but it also pays benefits to qualified disabled workers.<sup>220</sup> Proponents of partial privatization frequently do not address the effect of partial privatization on disability benefits because, in principle, it is possible to separate disability benefits from retirement benefits.<sup>221</sup> In fact, however, most partial privatization proposals would reduce disability benefits, albeit, in different ways.

Any reduction in disability benefits is likely to have an adverse effect on minorities and lower-income workers because they tend to benefit disproportionately from the current system's provision of disability benefits.<sup>222</sup> The degree to which these groups, and women, would be impacted, however, depends in large part on whether benefits continue to be based on a progressive benefit formula, like in the IA plan, or are provided as a flat amount, like in the PSA plan.

Most partial privatization proposals continue to calculate disability benefits in a manner similar to that under the current system, but limit the disability benefit to the first tier benefit available under the partially privatized system. Because most partial privatization proposals provide a first tier benefit that is smaller than the total benefit available under the current system, most partial privatization proposals offer a smaller disability benefit than is available under the current system.

The Advisory Council's IA plan, for example, continues to calculate disability benefits in the same manner as under the current system. The IA plan, however, would adjust the benefit formula to reduce gradually the current system's replacement rate for middle earnings from 32% to 22.4% and from 15% to 10.5% for high earnings.<sup>223</sup> In so doing, the IA plan would gradually reduce the first tier benefit and consequently the disability benefit available to middle- and high-wage workers. Although the IA plan provides for a second tier benefit

220. See 42 U.S.C. § 423(a)(1) (1996). For a discussion of Social Security's disability benefits, see Moore, *supra* note 3, app.

221. See DIFFERENT APPROACHES, *supra* note 33, at 59 ("Disability and dependents' benefits are often not included in the discussion of individual accounts because it is, in principle, possible to separate them from retirement benefits.").

222. See Moore, *supra* note 3, § III(C).

223. I ADVISORY COUNCIL REPORT, *supra* note 21, at 29; see Moore, *supra* note 3, app. (discussing the current system's replacement rates and how benefits are calculated); see also *Testimony Before the Subcomm. on Social Security, House Comm. on Ways and Means, Social Security Reform: Implications for the Financial Well-Being of Women*, GAO/T-HEHS-97-1128 (1997) [hereinafter *Well-Being of Women*] (Statement of Jane L. Ross, Director, Income Security Issues, Health, Education, and Human Services Division of the General Accounting Office) ("On the basis of calculations by the National Academy of Social Insurance, the IA plan would lower basic benefits by 17 percent for the average earner").

that might offset some of this reduction in benefit for retired workers, the second tier benefit would not be available to disabled workers until they reach age sixty-two.<sup>224</sup>

The PSA plan would also continue to calculate disability benefits in the same manner as under present law. Those benefits, however, would be capped at the first tier benefit available under that plan. When fully phased in, the Advisory Council's PSA plan would provide a full first tier flat benefit of \$410 per month in 1996 dollars for workers with thirty-five or more years of covered employment, while the current system paid retired workers an average of \$745 per month in 1996.<sup>225</sup> As a result of this substantial reduction in first tier benefits, the PSA plan would necessarily reduce disability benefits. Indeed, advocates of the PSA plan acknowledge that when fully phased in,<sup>226</sup> the PSA plan would reduce disability benefits by thirty percent.<sup>227</sup> Advocates of the PSA plan express some discomfort with the substantial reduction in disability benefits that their proposal would produce,<sup>228</sup> but view it as a necessary evil.<sup>229</sup> Critics of the plan, in contrast, view the substantial reduction as unacceptable.<sup>230</sup> Like

224. DIFFERENT APPROACHES, *supra* note 33, at 59-60 ("Under the IA plan, the essential structure of DI would remain intact, but the benefits for DI beneficiaries would be reduced because individual investment benefits needed to offset the reduction in program benefits would not be available until age 62.").

225. SOCIAL SECURITY ADMINISTRATION, 1997 ANNUAL STATISTICAL SUPPLEMENT TO THE SOCIAL SECURITY BULLETIN 13 (1997); *see also Well-Being of Women*, *supra* note 223, at 8 ("On the basis of calculations by the National Academy of Social Insurance . . . the PSA plan would lower the basic or tier I benefit to about 47 percent of the benefit paid to today's average earner.").

226. The Advisory Council's PSA plan would begin to reduce benefits by .5% for workers eligible for benefits in 2000. The size of the reduction would increase over time, reaching 20% for workers eligible for benefits in 2035 and reaching a limit of 30% in 2085. *See* I ADVISORY COUNCIL REPORT, *supra* note 21, at 125.

227. I ADVISORY COUNCIL REPORT, *supra* note 21, at 125.

228. I ADVISORY COUNCIL REPORT, *supra* note 21, at 125 ("Certainly, we would have preferred to eliminate the subsidies for older people choosing disability benefits over retirement benefits without reducing protection for younger people with disabilities, many of whom are seriously disabled and have little choice about working.").

229. I ADVISORY COUNCIL REPORT, *supra* note 21, at 125. The Report noted: There was no simple answer to this problem, however. Disabilities do not tend to be all-or-none, and disability decisions typically are not black-and-white. There is considerable room for discretion in decision making, particularly for workers at older ages. The DI program has been growing very rapidly in recent years and failing to deal with this problem, in our view, would have been fiscally irresponsible.

*Id.*

230. I ADVISORY COUNCIL REPORT, *supra* note 21, at 100. The report noted: We find it extraordinary that the sponsors of the PSA plan propose reducing disability benefits for young workers by as much as 30 percent, not by design, but in their view as the inevitable result of changes they believe are desirable

the IA plan, the PSA plan would provide second tier benefits that could help offset some of this reduction, but the second tier benefit would not be available until the worker reached retirement age.<sup>231</sup>

Partial privatization might adversely affect disabled workers in a second way. Presumably, disabled workers would be unable to contribute to their second tier individual accounts while they were disabled.<sup>232</sup> Their inability to contribute to their individual account would likely result in disabled workers having much lower accumulations in their account balances at retirement age than nondisabled workers.<sup>233</sup>

Minorities and lower-wage workers benefit disproportionately from the current Social Security system's disability benefit provisions for two reasons: (1) they disproportionately benefit from the progressive benefit formula, and (2) they are more likely to receive disability benefits than are whites and higher-income workers.<sup>234</sup> Women also tend to benefit disproportionately from the progressive benefit formula, but are less likely to receive disability benefits than are men.<sup>235</sup>

To the extent that all three at-risk groups disproportionately benefit from the current Social Security program's disability benefit provisions because of its progressive formula, it appears that the IA plan's reduction in disability benefits would not have as great an impact on these groups as on middle- and higher-income workers. As discussed above, the IA plan retains a progressive benefit formula; it simply decreases the replacement rates for middle- and higher-income workers. Thus, the IA plan's reduction in disability benefits would appear to reduce disproportionately the benefits of higher- and middle-income workers, while essentially retaining the same benefits for lower-income workers.

---

for older workers. . . . But, in any event, why is it more important to avoid notches (or such disparity of treatment) than to avoid poverty for young disabled workers?

*Id.*

231. Cf. I ADVISORY COUNCIL REPORT, *supra* note 21, at 125 (asserting that "the impact of the PSA proposal on workers who become disabled is mitigated when these workers reach age 62 and are able to gain access to their PSA accumulations"); DIFFERENT APPROACHES, *supra* note 33, at 60 (contending that "DI beneficiaries would not have access to their individual accounts until age 65, the proposed early retirement age under the PSA proposal").

232. Of course, disabled workers may be viewed as benefitting because they do not need to pay payroll taxes while they are unable to earn an income. Similarly, under the current system, disabled workers who have no covered wages do not have to pay payroll taxes.

233. Arguably, disabled workers may be similarly adversely affected under the current system because their careers may be cut short and thus they may not have years of higher earnings that can be taken into account in calculating their retirement benefits.

234. See Moore, *supra* note 3, § III(C).

235. See Moore, *supra* note 3, § III(C).

Although the PSA plan retains some progressivity in its disability benefit because it provides a flat benefit financed by a percentage of pay,<sup>236</sup> it appears that the PSA plan would decrease substantially the disability benefits for almost all workers. When fully phased in, the PSA plan would provide a first tier benefit equal to \$410 per month in 1996 dollars, the equivalent of 76% of the benefit payable to a low-wage worker retiring in 1996.<sup>237</sup> This suggests that the PSA disability benefit would represent a substantial reduction in benefit even for low-wage workers. Indeed, only 11.5% of disabled workers received monthly disability benefits of less than \$400 in 1996, and another 7.2% of disabled workers received benefits that ranged between \$400 and \$450 per month.<sup>238</sup> Thus, it appears that the PSA plan would reduce disability benefits for more than eighty percent of workers, including all three groups of at-risk beneficiaries who currently benefit from the progressive benefit formula.

To the extent that the partial privatization proposals rely on second tier benefits to make up for decreased first tier benefits, disabled workers who have no wages and thus cannot contribute to their individual accounts are disproportionately adversely affected by partial privatization. Accordingly, to the extent that minorities and lower-income workers tend to benefit disproportionately from the current program's disability benefit provisions because they are more likely to receive those benefits, it appears that both of these groups would be disproportionately adversely affected by partial privatization's reduction in those benefits.

Arguably, all workers could protect against partial privatization's likely reduction in disability benefits by purchasing disability benefits from the private market.<sup>239</sup> Workers, however, are unlikely to be able to obtain the same coverage for the same price through the private market. Under the current system, Social Security disability benefits are universal; that is, they are available to all workers regardless of age or occupation. The private market, in contrast, is unlikely to offer universal coverage.<sup>240</sup> Moreover, to the extent that

236. See *supra* notes 201-07 and accompanying text.

237. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 31.

238. See SOCIAL SECURITY ADMINISTRATION, 1998 ANNUAL STATISTICAL SUPPLEMENT TO THE SOCIAL SECURITY BULLETIN 216 tbl.5.D2 (1998) [hereinafter 1998 STATISTICAL SUPPLEMENT].

239. See Schieber, *supra* note 3, at 162 ("If Social Security did not provide insurance against disability and premature death, it is likely that many workers would buy alternative term insurance to cover these contingencies."); cf. DIFFERENT APPROACHES, *supra* note 33, at 59 (discussing option of purchasing disability insurance through private market).

240. See DIFFERENT APPROACHES, *supra* note 33, at 59. The GAO noted: A key feature of the benefits provided by Social Security is that they are universal—that is, they are generally available to everyone regardless of age or occupation. This would generally not be the case with individual disability insurance policies, and even the current employer-provided group

disability insurance is available, it is likely to be more costly for those most likely to need it.<sup>241</sup>

### *E. Auxiliary Benefits*

In addition to paying benefits to retired and disabled workers, the current Social Security system pays auxiliary benefits to the spouses, surviving spouses, and dependent children of retired disabled and deceased workers.<sup>242</sup> Proponents of partial privatization frequently do not address the effect of partial privatization on auxiliary benefits for spouses, surviving spouses, and children because, in principle, it is possible to separate auxiliary benefits from retirement benefits.<sup>243</sup> In fact, however, most privatization proposals would reduce auxiliary benefits.

Partial privatization's reduction in spouse and surviving spouse benefits is likely to have an adverse impact on the benefits of some, but not all, women. In addition, partial privatization's reduction in dependent child benefits is likely to have an adverse impact on nonwhites.

#### 1. Spouse and Surviving Spouse Benefits

Most proposals to partially privatize Social Security retain the current system's provision of spouse and surviving spouse benefits, but base those benefits on a percentage<sup>244</sup> of the worker's first tier benefit rather than the worker's entire benefit, as does the current system.<sup>245</sup> Moreover, most partial privatization proposals provide a first tier benefit that is smaller than the total benefit promised under the current system.<sup>246</sup> By basing spouse and surviving

---

arrangements might be subject to certain restrictions.

*Id.*

241. See DIFFERENT APPROACHES, *supra* note 33, at 59 ("A voluntary private disability insurance program, combined with insurers who might want to avoid the problem of adverse selection, suggests that comprehensive disability protection would be available to some only at a high price."); Kijakazi, *supra* note 17, at 23 ("The greater the physical risk of the occupation and the less healthy the worker, the greater the probability of not qualifying for coverage and the higher the premium for those who do qualify.").

242. See Moore, *supra* note 3, app. For a discussion of how those benefits affect redistribution within the current system, see Moore, *supra* note 3, § III(D).

243. See DIFFERENT APPROACHES, *supra* note 33, at 59 ("Disability and dependents' benefits are often not included in the discussion of individual accounts because it is, in principle, possible to separate them from retirement benefits.").

244. For a discussion of changes the proposals make in the percentage of the worker's benefit on which the spouse and surviving spouse benefits are based, see *infra* notes 291-93 and accompanying text.

245. See Moore, *supra* note 3, app. (discussing how spouse and surviving spouse benefits are calculated under the current system).

246. For a description of how the IA and PSA plan would provide first tier benefits

spouse benefits on the smaller first tier benefit, partial privatization proposals may reduce the total benefit spouse and surviving spouse beneficiaries receive. How this reduction in spouse and surviving spouse benefits would likely affect women<sup>247</sup> depends on the degree to which they must rely on their husbands' earnings for their social security benefits.<sup>248</sup>

Even though women's participation rate in the labor force has increased dramatically since the inception of Social Security,<sup>249</sup> the majority of women still receive Social Security benefits based wholly or in part on their husband's earning record.<sup>250</sup> Of the 21 million women aged 62 or older who received Social Security benefits in 1997,<sup>251</sup> only 7.8 million, or 36.9%, received benefits based solely on their own earnings record.<sup>252</sup> In contrast, 7.7 million, or 36.4%, of these women received benefits solely as wives or widows based on their husband's earnings record,<sup>253</sup> and the remaining 5.6 million, or 26.7%, were classified by the Social Security Administration as "dually entitled" and thus received benefits based partially on their own earnings and partially on their

---

that are less than the total benefit available under the current system, see *supra* notes 201-07 and accompanying text.

247. Between 98% and 99% of all spouse and surviving spouse benefits go to women. See Moore *supra* note 3, § III(D)(1).

248. Any such reduction in benefits could be offset by providing women with a protected interest in their spouses' second tier benefit, but not all partial privatization proposals provide such protections.

249. See, e.g., GENERAL ACCOUNTING OFFICE, SOCIAL SECURITY: ISSUES INVOLVING BENEFIT EQUITY FOR WORKING WOMEN GAO/HEHS-96-55, at 26 (1996) [hereinafter WORKING WOMEN] (noting that "[i]n 1940, only 28 percent of all women were in the labor force, and less than 15 percent of married women were working. By 1993, almost 60 percent of all women were in the labor force and married women were slightly more likely than other women to be working"); Marianne A. Ferber, *Women's Employment and the Social Security System*, SOC. SEC. BULL., Fall 1993, at 33 (noting that while less than 28% of women aged 16 or older participated in the labor force in 1940, by 1991 almost 60% of such women participated in the labor force); *Hearing before the Subcomm. on Retirement Income and Employment of the House Select Comm. on Aging, How Will Today's Women Fare in Yesterday's Traditional Retirement System?*, 102d Cong. 33 (1992) (statement of William J. Hughes, Chairman, Subcomm. on Retirement Income and Employment) (noting that "except for one glip right after the war where it dropped between 1945 and 1950, until the present time, there is a continued upward movement of women in the work force").

250. As discussed above, although Social Security's spouse and surviving spouse benefits are facially gender-neutral, the benefits are awarded almost exclusively to women.

251. 1998 ANNUAL STATISTICAL SUPPLEMENT, *supra* note 238, at 201 tbl.5.A14. (excluding special age-72 beneficiaries and adults receiving benefits because of childhood disability).

252. 1998 ANNUAL STATISTICAL SUPPLEMENT, *supra* note 238, at 201 tbl.5.A14.

253. 1998 ANNUAL STATISTICAL SUPPLEMENT, *supra* note 238, at 201 tbl.5.A14.

husband's earnings.<sup>254</sup> If current trends continue,<sup>255</sup> a substantial percentage of women are expected to continue to rely on their husband's earnings records for part or all of their Social Security benefits for the foreseeable future.<sup>256</sup>

Of course, partial privatization's reduction in spouse and surviving spouse benefits is unlikely to affect the benefits of women who do not rely on their husband's earnings for their benefits and thus do not receive those benefits.<sup>257</sup> Partial privatization, however, may reduce the total benefits of women who do currently collect spouse or surviving spouse benefits.

Women who rely solely on their husband's earnings for their Social Security benefits are likely to receive lower total benefits under a partially privatized system than under the current system<sup>258</sup> because their spouse and surviving spouse benefits are based solely on a percentage of their working spouse's lower first tier benefit.<sup>259</sup> Arguably, these women's decreased spouse

254. 1998 ANNUAL STATISTICAL SUPPLEMENT, *supra* note 238, at 201 tbl.5.A14.

255. In 1960, about 57% of older women beneficiaries received benefits based exclusively on their husband's earnings, while about 38% received benefits based solely on their own earnings, and about 5% were dually entitled and thus received benefits based in part on their own earnings and in part on their husbands' earnings. By 1988, only about 40% of older women beneficiaries received benefits based solely on their husband's earnings, while about 38% received benefits based solely on their own earnings records, and 22% were dually entitled receiving benefits based partially on their own earnings and partially on their husband's earnings. See Barbara A. Lingg, *Women Beneficiaries Aged 62 or Older, 1960-88*, SOC. SEC. BULL., July 1990, at 2.

256. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 143 ("The Social Security Administration projects that roughly 60 percent of wives who retire in 2015 will receive worker benefits and no spouse benefits. The remainder will either be dually entitled (roughly 35 percent) or receive spouse benefits only (roughly 5 percent.)"); Howard M. Iams, *Earnings of Couples: A Cohort Analysis*, SOC. SEC. BULL., Fall 1993, at 22 (stating that "[if] these earnings patterns continue through retirement age, the majority of wives born in the 1930's and 1940's and two-fifths of those born in the 1950's can expect to receive spouse benefits, and, if widowed, most can expect to receive widow benefits based on their husband's covered earnings.").

257. To the extent that these women have husbands who rely on their wife's earnings for their benefits, the husband's total benefits may be decreased. However, 98% to 99% of the spouse and surviving spouse beneficiaries are women. See *supra* note 247 and accompanying text.

258. Indeed, the proponents of the Advisory Council's IA and PSA plans implicitly recognize this fact by noting that almost all single-earner couples are projected to receive higher internal rates of return under the Advisory Council's MB plan, which essentially retains the current system, than under the IA or PSA plan. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 43-44. Only low-wage single-earner couples are expected to receive equal rates of return under the PSA and MB plans. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 44; see also DIFFERENT APPROACHES, *supra* note 33, at 60 (noting that partial privatization proposals imply reduced spousal benefits).

259. The spouses of lower-wage workers might not receive spouse or surviving spouse benefits under the Advisory Council's IA plan because the IA plan only reduces

or surviving spouse benefits could be offset by their spouse's increased second tier benefit. Not all partial privatization proposals, however, give women a protected interest in their spouse's second tier benefit.

Current law generally requires that private pension benefits be paid out in the form of a joint-and-survivor annuity<sup>260</sup> unless the spouse elects otherwise,<sup>261</sup> and a number of privatization proposals include a similar provision. For example, the Advisory Council's IA plan requires that the worker's individual account balance be annuitized upon retirement and "[a]s is the case with other pension plans, a married worker would have a choice (with the consent of the spouse) on whether a single or 'joint and survivor' annuity was chosen."<sup>262</sup> Similarly, the National Commission on Retirement Policy recommends that individuals be required "to annuitize that portion of their individual savings account balances which, when added to their traditional Social Security benefit, is necessary to provide an income comfortably above the poverty line,"<sup>263</sup> and that "the annuities . . . be similar to those required to be offered to plan participants under qualified defined benefit plans subject to [ERISA]."<sup>264</sup>

The Advisory Council's PSA plan, in contrast, does not require that a worker's account balance be annuitized upon retirement.<sup>265</sup> Surviving spouses

first tier benefits for middle- and high-wage earners.

260. See 29 U.S.C. § 1055 (1994). A joint-and-survivor annuity pays benefits for the remainder of the lifetime of both the worker and the worker's beneficiary, in this case, the worker's spouse.

261. Generally, the Employee Retirement Income Security Act of 1974 ("ERISA") requires that private pension benefits be paid out in the form of a joint and survivor annuity. See 29 U.S.C. § 1055 (1994). For a critical analysis of the 1983 legislation enacting this requirement, see Camilla E. Watson, *Broken Promises Revisited: The Window of Vulnerability for Surviving Spouses Under ERISA*, 76 IOWA L. REV. 431, 472-86 (1991).

262. I ADVISORY COUNCIL REPORT, *supra* note 21, at 28.

263. THE 21ST CENTURY RETIREMENT SECURITY PLAN, *supra* note 24, at 13.

264. THE 21ST CENTURY RETIREMENT SECURITY PLAN, *supra* note 24, at 13. For a similar recommendation, see Forman, *supra* note 107, at 1680-84 (recommending that at a minimum couples be required to annuitize their account balances to the extent necessary for their total benefits (including first tier benefits) to provide the equivalent of an indexed annuity equal to 125% of the poverty level; also recommending that spouses be entitled to information about their spouse's individual accounts, and that they be required to give consent to significant withdrawals). The Committee for Economic Development favors requiring workers to annuitize their individual account balances upon retirement but does not specifically address spousal interests in those account balances. See FIXING SOCIAL SECURITY, *supra* note 23, at 51. The Committee's plan recommends that existing ERISA regulations be incorporated to the extent possible, see FIXING SOCIAL SECURITY, *supra* note 23, at 51, however, it suggests that the Committee might also endorse joint and survivor annuities as a default payout option.

265. I ADVISORY COUNCIL REPORT, *supra* note 21, at 30. Moreover, the PSA plan does not require that retired workers elect joint-and-survivor annuities if they elect to



are "eligible" to inherit any balance in their deceased spouse's individual account,<sup>266</sup> but they are not guaranteed any interest in that account. Instead, "[t]he personal savings account would belong to the partner who earned it, and the entitlement of the lower-earning spouse or survivor to a share would depend upon the generosity of the higher-earning spouse or the divorce courts."<sup>267</sup> Thus, women who rely solely on their husband's earning record for their Social Security benefits are likely to receive lower spouse and surviving spouse benefits under a partially privatized system and those decreased benefits may or may not be offset by an interest in their spouse's second tier benefits, depending on the terms of the particular partial privatization proposal and the generosity of their spouse.

Like women who rely solely on their husband's earnings record for their Social Security benefits, dually entitled women are also likely to receive smaller spouse and surviving spouse benefits under a partially privatized system and their reduced spouse and surviving spouse benefits may or may not be offset by an interest in their spouse's second tier benefit. Unlike women who rely solely on their husband's earnings record for their Social Security benefits, however, dually entitled women under a partially privatized system are also entitled to a second tier individual account benefit based solely on their own earnings record.<sup>268</sup> Depending on the size of their individual account, dually entitled women could receive second tier benefits that more than make up for any reduction in their spouse and surviving spouse benefits regardless of whether they have any interest in their spouse's second tier benefit.<sup>269</sup>

With respect to a specific breakdown of effect, partial privatization's reduction in spouse benefits may have a disproportionately adverse impact on

annuitize their second tier benefit upon retirement. Based upon current trends, it appears unlikely that working spouses would voluntarily elect joint-and-survivor annuities unless joint-and-survivor annuities were the default option as they currently are in employer pensions. Cf. Diamond, *supra* note 188, at 47 (noting that if "left on their own, many workers tend to select single-life as opposed to joint-and-survivor annuities . . . the degree of joint-life annuitization is very sensitive to system design").

266. I ADVISORY COUNCIL REPORT, *supra* note 21, at 32.

267. I ADVISORY COUNCIL REPORT, *supra* note 21, at 150.

268. When fully implemented, the Advisory Council's PSA plan would also provide dually entitled beneficiaries who work more than 10 years with an increased first tier benefit. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 31 ("For individuals who do not work a full career, half of the flat benefit [\$410 in 1996 dollars] would be earned with 10 years of covered earnings, with a 2-percent increment for each additional year of work up to 25 years.").

269. In 1997, dually entitled wives received total benefits ranging from less than \$200 per month to more than \$1,000 per month, with an average total benefit of \$460 per month. See 1998 ANNUAL STATISTICAL SUPPLEMENT, *supra* note 238, at 232 tbls.5.G4, 5.G3. Dually entitled widowers received total benefits ranging from less than \$200 per month to more than \$1,200 per month, with an average total benefit of \$867 per month.

See 1998 ANNUAL STATISTICAL SUPPLEMENT, *supra* note 241, at 232 tbls.5.G4, 5.G3.

white women and the wives of higher-income workers because they are more likely to collect those benefits than are black women or the wives of lower-income workers.<sup>270</sup> On the other hand, partial privatization's reduction in survivor benefits may affect women of all races approximately equally because they are equally likely to collect those benefits.<sup>271</sup>

Reducing spouse and surviving spouse benefits may very well represent good public policy: the auxiliary benefit provisions are subject to criticism on a number of grounds.<sup>272</sup> First, they create inequities in the treatment of dual-earner couples vis-a-vis single-earner couples.<sup>273</sup> Generally, the spouse and surviving spouse benefit provisions result in single-earner couples receiving higher combined monthly benefits in retirement than two-earner couples with identical lifetime earnings (and all other relevant characteristics, such as age).<sup>274</sup> In addition, the spouse and surviving spouse benefit provisions may be unfair to secondary earners (usually women) because they limit the secondary earner to the higher of their spouse/surviving spouse benefit or their benefit based on their own earnings record.<sup>275</sup> Thus, secondary earners may work and pay Social Security taxes for years and yet receive no additional benefit for their contributions.<sup>276</sup> Furthermore, this limitation may create work disincentives<sup>277</sup>

270. See Moore, *supra* note 3, § III(D)(1).

271. See Moore, *supra* note 3, § III(D)(1).

272. For an excellent overview of the current system's treatment of women, see Karen C. Burke & Grayson M.P. McCouch, *Women, Fairness, and Social Security*, 82 IOWA L. REV. 1209 (1997).

273. The auxiliary benefit provisions also create inequities in the treatment of unmarried workers relative to married couples because unmarried workers are ineligible for the auxiliary benefits. Cf. Burke & McCouch, *supra* note 272, at 1230 n.119 (noting that "in present value terms, a married couple's benefits may exceed those of an unmarried individual by as much as 100%, based on identical payroll taxes").

274. For a more detailed explanation and illustrations of how single-earner couples often receive larger benefits than dual-earner couples with identical lifetime earnings, see, e.g., WORKING WOMEN, *supra* note 249, at 15-21; Burke & McCouch, *supra* note 272, at 1209; Jonathan Barry Forman, *Promoting Fairness in the Social Security Retirement Program: Partial Integration and a Credit for Dual-Earner Couples*, 45 TAX LAW. 915, 933 (1992).

275. See 42 U.S.C. § 402(b)(1)(B), (c)(1)(B) (1994); 1998 SOCIAL SECURITY EXPLAINED, *supra* note 102, ¶ 522.

276. WORKING WOMEN, *supra* note 249, at 21 ("It is sometimes argued that such a limitation is unfair because it does not sufficiently reward a person for years of contributions."); Forman, *supra* note 274, at 946 (describing the limitation as a "penalty on secondary workers").

277. Interestingly, the number of secondary earners has steadily increased since the inception of Social Security despite this apparent work disincentive. See, e.g., Lingg, *supra* note 255, at 5 (noting that percentage of dually entitled older women beneficiaries has increased from 5% in 1960 to 22% in 1988, while the percentage of older women beneficiaries relying exclusively on their husband's earnings record for benefits has

for the secondary earner in a two-earner couple.<sup>278</sup> Finally, despite the fact that the spouse and surviving spouse benefit provisions were designed to satisfy the presumptive need of dependents,<sup>279</sup> they actually tend to provide the greatest benefit to those least in need—women who do not work and who are married to high earners.<sup>280</sup>

Reducing spousal and survivor benefits, however, does not unequivocally constitute good public policy. Reducing survivor benefits could put elderly widows, who are already particularly vulnerable to poverty under our current system,<sup>281</sup> at an increased risk of poverty.<sup>282</sup>

decreased from about 57% in 1960 to 40% in 1988 and the percentage of older women beneficiaries receiving benefits based solely on their own earnings record has remained steady at about 38%). Cf. Anne L. Alstott, *Tax Policy and Feminism: Competing Goals and Institutional Choices*, 96 COLUM. L. REV. 2001, 2018 (1996) (noting that “a tax incentive does not necessarily affect actual behavior”).

278. See, e.g., Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 U.C.L.A. L. REV. 983, 999 (1993) (stating that auxiliary benefit provisions “undermine[] the incentive of the potentially second-earner spouse to enter the work force”).

279. See, e.g., FINAL REPORT OF THE [1937-38] ADVISORY COUNCIL ON SOCIAL SECURITY, reprinted in REPORT OF THE COMMITTEE ON ECONOMIC SECURITY OF 1935, at 175, 189 (50th Ann. ed. 1985) (“Payment of supplementary allowances to annuitants who have wives over 65 will increase the average benefit in such a manner as to meet the greatest social need with the minimum increase in cost.”). See also Burke & McCouch, *supra* note 272, at 1214-15 (“When derivative benefits were first introduced, they were justified on grounds of social adequacy. A supplementary benefit for a retired worker’s dependent family members was considered necessary, in view of the relatively low level of primary benefits during the early years of social security.”); Forman, *supra* note 274, at 935-36 (noting that auxiliary benefits help program provide socially adequate benefits to all beneficiaries).

280. See, e.g., Burke & McCouch, *supra* note 272, at 1230 (“From the perspective of social adequacy, the spousal benefit provisions also function poorly. Spousal benefits are often inversely related to need, resulting in an upside-down subsidy to middle- and high-wage married couples—a ‘dubious redistributive achievement.’”) (quoting Richard V. Burkhauser, *Alternative Social Security Responses to the Changing Role of Women and Men*, in CONTROLLING THE COST OF SOCIAL SECURITY 141, 146 (Colin D. Campbell ed., 1984)); Madonna Harrington Meyer, *Making Claims As Workers or Wives: The Distribution of Social Security Benefits*, 61 AM. SOC. REV. 449, 462 (1996) (“Neither can the [auxiliary] benefits be justified as antipoverty efforts; those with the largest monthly benefits are significantly more likely than those with meager benefits to receive noncontributory benefits.”). Cf. Karen C. Holden, *Spouse and Survivor Benefits: Distribution among Aged Women*, 1 RES. ON AGING 301, 310 (1979) (noting that “[w]hile equally distributed among couples, spouse benefits, designed as an antipoverty measure, fail to target those couples most in need of additional income”).

281. The poverty of elderly widows may be more attributable to their lack of income from other sources than to low Social Security benefits. See WORKING WOMEN, *supra* note 249, at 57. The GAO noted:

Most widows already receive social security benefits based on their deceased

Although over the last three decades, Social Security has dramatically reduced the percentage of elderly who are poor,<sup>283</sup> unmarried older women remain disproportionately poor.<sup>284</sup> For example, while only 4.4% of married couples aged 65 or older had income that fell below the poverty line in 1996, the income of 19.8% of unmarried women aged 65 or older fell below the poverty line that year.<sup>285</sup> Similarly, while only 8.4% of married couples aged 65 or older had income that fell below 125% of the poverty line in 1996, the income of 32.3% of unmarried women aged 65 or older fell below 125% of the poverty line

---

husbands' work records and these benefits are indexed to offset the effects of inflation, thus maintaining the benefits' purchasing power over time. Other sources of income, such as private pensions and income from assets, are rarely indexed and sometimes disappear upon the death of the spouse who 'owned' them.

WORKING WOMEN, *supra* note 249, at 57. For additional discussion of the reasons why elderly unmarried women tend to be poor, see LOIS SHAW ET AL., *THE IMPACT OF SOCIAL SECURITY REFORM ON WOMEN* 3-7 (1998).

282. Of course, as noted above, some commentators contend that the present auxiliary benefit provisions are not a particularly effective anti-poverty program because the women who are in the best position to benefit from the provisions—married women who do not work and who are married to high wage-earners—are in the least need. *See supra* text accompanying note 280. Interestingly, though, the empirical work of one analyst shows that survivor benefits generally do a better job of targeting poor elderly widows' poverty than spousal benefits do of targeting poor elderly couples. *See* Holden, *supra* note 280, at 313 (noting that "[t]he [Supplemental Widow's Benefits] do appear to target poor, once-married women, paying 79.4% of these benefits to the 63.6% of women who would be poor with only retired worker benefits and other incomes").

283. *See* Moore, *supra* note 3, § II.

284. Although all unmarried women are at a disproportionately greater risk of poverty in older age, this Section focuses only on widows because they are the group of unmarried older women most affected by spouse and surviving spouse benefits. Older women who have never married are by definition ineligible for benefits based on their spouse's earnings record. In addition, while Social Security provides for spouse and surviving spouse benefits for divorced older women, few divorced women receive such benefits. *See* David A. Weaver, *The Economic Well-Being of Social Security Beneficiaries, with an Emphasis on Divorced Beneficiaries*, 60 SOC. SEC. BULL., Fall 1997, at 3, 5 (1997) ("Most aged women with a marital status of divorced do not receive divorced spouse benefits. This is partly because many divorced women have earnings histories that entitle them to higher primary benefits."). The GAO found:

[M]ost divorced women do not qualify for divorced spouse benefits because most marriages that end in divorce last less than 10 years, the minimum marriage duration needed to qualify for such benefits. In addition, many divorced women who were married at least 10 years do not receive divorced spouse benefits because they either subsequently remarry or have retired worker benefits that exceed their benefit as a divorced spouse.

WORKING WOMEN, *supra* note 249, at 36.

285. U.S. DEP'T OF HEALTH & HUMAN SERVICES., *supra* note 93, at 125 tbl.VIII.1.

that year.<sup>286</sup> Indeed, unmarried women constitute more than 70% of the poor elderly households even though they only represent 45% of all elderly households.<sup>287</sup> Moreover almost two-thirds of all older women living in poverty are widows,<sup>288</sup> and "longitudinal data show that the death of a husband markedly increases the likelihood of poverty."<sup>289</sup>

A partially privatized system could reduce the risk of poverty for elderly widows by increasing surviving spouse benefits.<sup>290</sup> In fact, some, but not all, partial privatization proposals do so. For example, the Advisory Council's IA plan would shift benefits from spouses to surviving spouses by gradually reducing the spouse benefit to thirty-three percent of the worker's benefit and increasing the surviving spouse benefit to the highest of (1) his or her own basic benefit, (2) the deceased spouse's basic benefit, or (3) seventy-five percent of the couple's combined basic benefits.<sup>291</sup> The Advisory Council's PSA plan would retain the spouse benefit at fifty percent of the worker's benefit but gradually increase the surviving spouse benefit to seventy-five percent of the couple's first tier benefit.<sup>292</sup> The Council on Economic Development, in contrast, recommends gradually reducing the spouse benefit to thirty-three percent of the worker's benefit while retaining the surviving spouse benefit at one hundred percent of the worker's benefit.<sup>293</sup>

A partially privatized system could also reduce the risk of poverty to elderly widows by requiring that, absent spousal consent, a married worker's individual account benefit be paid out in the form of a joint-and-survivor annuity upon the worker's retirement. Such a requirement would ensure that a surviving spouse has a protected interest in her working spouse's benefit that could not be spent prior to the working spouse's death or left to another beneficiary upon the working spouse's death. Some of the proposals, such as the Advisory Council's IA plan and the National Commission on Retirement Policy's proposal, contemplate such a requirement. Others, in contrast, like the Advisory Council's PSA plan, impose no such restrictions.

---

286. U.S. DEP'T OF HEALTH & HUMAN SERVICES, *supra* note 93, at 125 tbl.VIII.1.

287. WOMEN'S RETIREMENT INCOME, *supra* note 64, at 3.

288. See Steven H. Sandell & Howard M. Iams, *Reducing Women's Poverty By Shifting Social Security Benefits from Retired Couples to Widows*, 16 J. POL'Y ANALYSIS & MGMT. 279, 297 (1997).

289. *Id.* at 281.

290. *Id.* (analyzing three proposals to reduce couples' benefit income and increase survivors' benefits by an actuarially fair amount to reduce poverty of elderly widows).

291. I ADVISORY COUNCIL REPORT, *supra* note 21, at 29.

292. I ADVISORY COUNCIL REPORT, *supra* note 21, at 32.

293. FIXING SOCIAL SECURITY, *supra* note 23, at 17.

## 2. Dependent Child Benefits

Most proposals to partially privatize Social Security devote little attention to dependent benefits. For example, neither the proponents of the Advisory Council's IA plan nor the proponents of the Advisory Council's PSA plan even mention dependent child benefits in their overview of the "important specific provisions" of their plans.<sup>294</sup> Similarly, the Committee for Economic Development never refers to dependent child benefits in its summary of policy recommendations.<sup>295</sup>

In all likelihood, partial privatization would reduce dependent child benefits. To the extent that partial privatization proposals retain dependent child benefits, they would likely base those benefits on a percentage of the working parent's first tier benefit. Since first tier benefits under a partially privatized system are generally lower than total benefits under the current system,<sup>296</sup> dependent child benefits are likely to be lower under a partially privatized system than under the current system. Moreover, unlike spouses,<sup>297</sup> dependent children are unlikely to have a guaranteed interest in their parent's second tier benefit or have any of their own earnings on which they can rely for their own second tier benefits. Thus, partial privatization is likely to result in dependent children receiving decreased benefits.

Since nonwhites tend to benefit disproportionately from Social Security's dependent child benefits,<sup>298</sup> it appears that partial privatization's reduction in dependent child benefits would likely have a disproportionately adverse impact on this at-risk group.

## 3. Conclusion

In sum, partial privatization of Social Security is likely to lead to reduced spouse and surviving spouse benefits. For women who rely solely on their husband's earnings record for their Social Security benefits, the reduction in spouse and surviving spouse benefits would likely result in their receiving lower total benefits, although their reduced spouse and surviving spouse benefits might be offset by an interest in their husband's second tier benefit. Dually-entitled women would likely also receive reduced spouse and surviving spouse benefits that might or might not be offset by an interest in their husbands' second tier benefit. Unlike women who rely solely on their husbands' earning record,

---

294. See I ADVISORY COUNCIL REPORT, *supra* note 21, at 28-33.

295. See FIXING SOCIAL SECURITY, *supra* note 23, at 16-18.

296. For a description of how the IA and PSA plans would provide first tier benefits that are less than the total benefit available under the current system, see *supra* notes 201-05 and accompanying text.

297. See *supra* Part III(E)(1).

298. See Moore, *supra* note 3, § III(D)(2).

however, dually entitled women would also be entitled to a second tier benefit based on their own earnings record. Depending on the size of that second tier individual account benefit, it might or might not offset any reduction in spouse or surviving spouse benefits. Since white women are more likely to collect spouse benefits than are black women, and the wives of higher-income workers are more likely to collect spouse and survivor benefits than are the wives of lower-income workers, partial privatization's reduction in spouse benefits may have a disproportionately adverse impact on white women and the wives of higher-income workers. In contrast, since women of all races appear to be equally likely to collect surviving spouse benefits, partial privatization's reduction in survivor benefits would likely affect women of all races approximately equally.

Reducing spouse and surviving spouse benefits may represent good public policy for a variety of reasons. On the other hand, reducing surviving spouse benefits could subject elderly widows to an increased risk of poverty. Partial privatization could reduce this risk by increasing surviving spouse benefits and by requiring that absent spousal consent, second tier individual account benefits be converted to a joint-and-survivor annuity upon the worker's retirement. Some, but not all, partial privatization proposals provide these protections.

Although partial privatization proposals typically devote little attention to dependent child benefits, it appears that most proposals would reduce these benefits. Since nonwhites tend to disproportionately benefit from Social Security's dependent child benefits, a reduction in these benefits would likely have a disproportionately adverse impact on nonwhites.

#### IV. CONCLUSION

Determining how partial privatization would likely affect the benefits of any particular worker or group of workers is no easy task. The current Social Security system is extraordinarily complex and partially privatizing the system would create additional intricacies. Despite these complexities, it appears that on the whole partial privatization would likely have a disproportionately adverse impact on the benefits of women, minorities, and lower-income workers. Since these groups are already at a heightened risk of poverty in old-age, partial privatization of Social Security does not appear to be a wise idea.

Of course, this is not to suggest that other social security reform proposals may not also have a disproportionately adverse effect on at-risk beneficiaries. To illustrate, the General Accounting Office has found that racial minorities are particularly likely to be adversely affected by increases in the retirement age.<sup>299</sup>

---

299. GENERAL ACCOUNTING OFFICE, SOCIAL SECURITY REFORM: IMPLICATIONS OF RAISING THE RETIREMENT AGE GAO/HEHS-99-112, at 29 (1999); see also Julia Lynn Coronado et al., *Distributional Impacts of Proposed Changes to the Social Security System*, 13 TAX POL'Y & ECON. 149, 172-78 (1999) (finding that eliminating the drop-out

<https://scholarship.law.missouri.edu/mlr/vol65/iss2/1>

As this Author has explained elsewhere, partial privatization of Social Security does not appear to be a wise idea for additional reasons.<sup>300</sup>

Nevertheless, if policymakers insist on partial privatization of Social Security, they should take care to alleviate the adverse effects partial privatization may have on the at-risk groups to the extent possible. First, if Social Security is partially privatized, all workers can and should be provided with investment education. Although investment education would not eliminate all of the disadvantages the at-risk groups face, it would help level the playing field. Second, partial privatization should require that second tier benefits be annuitized upon retirement. Admittedly, mandatory annuitization would raise difficult timing issues and difficult questions regarding the proper life table to be used that could result in some of the at-risk groups receiving lower expected lifetime benefits because of their lower life expectancies. Nevertheless, annuitization should be required to protect the at-risk groups from the risk of outliving their second tier benefit. After all, the purpose of Social Security is to provide workers with retirement income, not an estate to be distributed at death.<sup>301</sup> Finally, partial privatization should require that, absent spousal consent, the second tier benefit of married workers be paid out in the form of a joint-and-survivor annuity to the worker and the worker's spouse. Although joint-and-survivor annuities would not eliminate all risk of poverty for elderly widows, they would be a step in the right direction.

---

years, increasing the retirement age, increasing the social security tax rate, and decreasing the benefit level across the board would all constitute regressive changes to the current system); Schieber, *supra* note 3, at 165 ("Social Security reform proposals that cut benefits across the board will have a disproportionately large effect on the retirement consumption potential of the people at the bottom end of the economic ladder, while the people at the upper end of the ladder will hardly notice a difference.").

300. See Moore, *supra* note 12, at 153-68 (contending that partial privatization of Social Security is misguided because (1) it does not guarantee workers better returns, (2) it imposes transition costs, (3) it promotes misguided paternalism, and (4) it misconceives the role Social Security should play in our national retirement system).

301. Cf. Richard L. Kaplan, *Retirement Funding and the Curious Evolution of Individual Retirement Accounts*, 7 ELDER L.J. 283, 303-10 (1999) (contending that the IRC § 4974(a) required distribution regime should be extended to Roth IRAs to ensure that they are used for their intended retirement purposes and not to build wealth to pass on to future generations).



